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UNITED STATES-CANADA FREE TRADE AGREEMENT—1988

HEARINGS

BEFORE THE

COMMITTEE ON FINANCE
UNITED STATES SENATE

ONE HUNDREDTH CONGRESS

SECOND SESSION

April 12 and 13, 1988

(Part 2 of 3)

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UNITED STATES-CANADA FREE TRADE AGREEMENT—1988

TUESDAY, APRIL 12, 1988

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 10:05 a.m. in Room SD-215, Dirksen Senate Office Building, Hon. Lloyd Bentsen (Chairman) presiding.

Present: Senators Bentsen, Matsunaga, Baucus, Mitchell, Riegle, Daschle, Packwood, Roth, Danforth, Heinz, Wallop, and Durenberger.

[The prepared statements of the Senators appear in the appendix.]

[The press release announcing the hearing follows:]

[Press Release No. H-16, March 29, 1988]

BENTSEN ANNOUNCES FINANCE COMMITTEE HEARINGS ON UNITED STATES-CANADA FREE TRADE AGREEMENT LEGISLATION

WASHINGTON, DC.—Senator Lloyd Bentsen (D., Texas), Chairman, announced Tuesday that the Committee on Finance will hold four days of hearings on the United States-Canada Free Trade Agreement in mid-April.

The hearings are scheduled for *Tuesday, April 12, Wednesday, April 13, Friday, April 15, and Thursday, April 21, 1988. All four hearings will be held at 10 a.m.* in room SD-215 of the Dirksen Senate Office Building.

Bentsen said, "Testimony from private enterprise is an important part of the Committee's consideration of the agreement. I anticipate that the legitimate concerns of domestic industries about the agreement will have to be addressed in the implementing legislation."

OPENING STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR FROM TEXAS, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. This hearing will come to order.

I would like to have Mr. Jack Sheinkman, Mr. Max Turnipseed, Mr. Carl Schwensen, Mr. Benjamin Cooper, and Mr. R.M. Cooperman. If you will come forward, gentlemen, and take a seat.

We heard last March the 17th of this year from the administration on the Canadian Free Trade Agreement, and now we want to hear from some of the public witnesses. We have had a great many requests to testify, and obviously we cannot accommodate all of them in oral testimony. But we have made a provision for those statements to be submitted to the record and we have already received a large number of those submissions.

Today, we are going to hear from a variety of witnesses representing various industries—agriculture, business, labor—and I am asking that you each limit your statement to 5 minutes. Now, we will take your entire statement for the record, but I want some chance for some interplay, for some questions of each of you by members of this Committee. And you are going to see quite a few members by the time we get well underway here.

I would like to defer to Senator Packwood for any comments he might want to make at this point.

OPENING STATEMENT OF HON. BOB PACKWOOD, A U.S. SENATOR FROM OREGON

Senator PACKWOOD. Mr. Chairman, this comment is not directed at the witnesses. I have read their testimony and I agree with some; not with some. I think it is good testimony. But I want to address my comments more at Canada. I get the sense from some of the actions that the Canadians are taking that they are trying to squeeze everything in they can before this agreement is finalized in the hopes that somehow it will be ratified by confirmation of the agreement by the House and the Senate.

I would simply say if Canada really wants this agreement—and I think they do—there is a point beyond which they cannot push the United States. I am assuming there is going to be a third of the Congress opposed to the agreement in any event. And all you need to do is add two, to four, to six Senators from a couple States involving textiles, and two, to four, to six Senators from a couple of States involving wheat, and two, to four, to six Senators from a couple of States involving fish, then the agreement fails. And I hope the actions that I find Canada taking in some of these areas does not gradually push us beyond the point where we cannot ratify this agreement.

The CHAIRMAN. Well let me further state in line with that that we cannot violate the objectives of the agreement arrived at by the negotiators. That is the understanding under which we proceed on this. We have taken some additional time, and the administration has agreed with us, in order that we can have this kind of a public discussion and see what we can do to accommodate, to the extent we can, some of these concerns. But within the framework of that agreement and the objectives already set forth, we are pretty well locked into that.

I would like to defer now to Senator Mitchell. Do you have any comments you would like to make?

Senator MITCHELL. Mr. Chairman, I have no opening statement.

The CHAIRMAN. All right.

Senator MITCHELL. I look forward to the testimony of the witnesses.

The CHAIRMAN. Thank you.

Senator Heinz?

OPENING STATEMENT OF HON. JOHN HEINZ, A U.S. SENATOR FROM PENNSYLVANIA

Senator HEINZ. Mr. Chairman, first, I just want to commend you and Senator Packwood on the process that you followed on this Canadian Free Trade Agreement. I think you have done an extraordinarily fine job in maintaining the Senate and congressional initiative. And it is you who have insisted on the process that I think it is and has proved to be an orderly one. It would not have happened without you, Mr. Chairman.

I would only like to make two other additional quick comments.

Obviously, many of us have concerns about this agreement. I have said on many occasions that I am concerned about the integrity of the process by which it is going to be considered and I think Senator Bentsen is working very hard on that.

I am concerned about the equity of the dispute settlement process, something Senator Mitchell has brought up again and again, and, importantly, the degree to which we can guarantee further progress on the barriers—and there are a lot of them—that are grandfathered. But I must say—and this is my third and concluding point—that since I made those comments, a new factor has entered this equation, and that is the Canadian Government's insistence on going forward with a textile duty remission scheme that is, to say the least, a violation of the spirit of the Canadian Free Trade Agreement. Particularly upsetting in this case and others is what can only be called the hypocracy of the Canadian Government. While its representatives are using every occasion to remind us of the standstill clause in the Agreement—and I might add, lobbying hard against provisions in the Trade Bill that they think would violate that clause—their colleagues in Ottawa are going full steam ahead with the imaginative devices beyond anything we have ever contemplated

Textiles is one case; dairy is another, and there are still others.

To say that these cases may ultimately involve small amounts of trade or are not technically violations of the Agreement, is to miss the point entirely.

The purpose of the Agreement is to redefine our trade relations with Canada in a more open and constructive way.

The recent Canadian actions suggest that in their minds very little has changed; that the Agreement does not represent a new era in our economic relationship, but just a different set of rules for the same old game.

If that is the case, I suspect very few of us on the Committee are going to be very excited about going forward with this Agreement.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Senator Wallop.

Senator WALLOP. Mr. Chairman, I have no opening statement other than again to add my thanks to those that have already been expressed to you for the process which you have set up. I appreciate it.

The CHAIRMAN. Thank you very much, Senator.

Mr. Jack Sheinkman is the president of the Amalgamated Clothing and Textile Workers Union, AFL-CIO, New York. Mr. Sheinkman, would you proceed?

STATEMENT OF JACK SHEINKMAN, PRESIDENT, AMALGAMATED CLOTHING AND TEXTILE WORKERS UNION, AFL-CIO, NEW YORK, NY, ACCOMPANIED BY ARTHUR GUNDERSHEIM, ASSISTANT TO THE PRESIDENT, AMALGAMATED CLOTHING AND TEXTILE WORKERS, AFL-CIO, NEW YORK, NY

Mr. SHEINKMAN. Mr. Chairman, I want to thank you for the opportunity to appear here. I have a speaking engagement a little later in the morning, and I have asked my assistant here, Mr. Arthur Gundersheim, to answer any questions that any of the Senators may have. This is a long-standing commitment and I will be leaving, unfortunately, prior to the time that the questions will arise.

The CHAIRMAN. I must say that we run into some of those same problems also. You go right ahead.

Mr. SHEINKMAN. Some years ago I read a book called "Candide," and in there is a character called "Tongglus," who says "Everything happens for the best." And I wonder where we stand here. And that is after he goes through a great deal of adversity.

I think both Senator Packwood and Senator Heinz have touched on a sensitive aspect of the particular subject matter I want to deal with.

We have entered into a bilateral agreement with Canada in terms of its trade in textile and apparel, and we find that some 6 months before the standstill clause takes place, Canada has entered into a duty remission arrangement, a duty remission arrangement with several aspects.

One, if there is certain value added as a result of Canadian production, those goods will come into the United States with a lower tariff arrangement or no tariff at all; likewise, certain fabrics that are not made outside of Canada will come into the United States tax-free; and, third, certain imported garments will be coming in, like mens' shirts and ladies' blouses. In effect, these garments and these textiles will be robbing both Canadian and American workers of their livelihood and will be circumventing, as Senator Heinz said, the intent of this Agreement.

We now operate under great difficulty, as the House Oversight Committee has indicated time and time again, with respect to the Customs Service. How can Customs Service, given its limited budget, and the problems that are already taking place in terms of its attempting to monitor the various trade agreements we have now, be able to handle the various ways fraud and circumvention will take place.

For example, will it be able to monitor what percentage of the content coming in from a Canadian apparel manufacturer was Canadian fabrics or foreign fabric, whether it met the standards set forth in the Agreement? These are the problems that the Canadian action does not answer and neither does the Agreement itself.

Moreover, I might point out that the administration has indicated that this is likewise a precedent of a similar agreement that we might enter into Mexico and could likely affect the general agreement—the GATT agreement—which could affect the United States in the long-term in this area.

What I find a little hard to take is at a time we are coping with a huge trade deficit, and by entering into these kind of arrangement what we are doing now is really adding to that deficit, robbing American workers of their jobs, and at the same time not meeting the basic problem that exists between Canada and the United States.

I might point out that the members we represent in Canada, some 30,000, have taken a similar position in opposition to this Agreement, because what is happening is it will rob textile workers of their jobs, while it may enable some of the apparel workers to gain additional employment.

In the long run, this kind of an arrangement undermines the intent of the so-called Canadian Free Trade Agreement by the various loopholes that have already been put into place, loopholes which cannot be answered if the bill is to be passed in its present form. And unless the Senate gets an answer to these questions, Mr. Chairman I don't know how in God's name it is going to be able to make certain that the provisions of the Agreement are going to be carried out.

Thank you very much.

[The prepared statement of Mr. Sheinkman appears in the appendix.]

The CHAIRMAN. Thank you, Mr. Sheinkman. Mr. Turnipseed, who is the Manager of the International Trade Affairs of the Ethyl Corporation, on behalf of the Office of the Chemical Industry Trade Advisor. Would you proceed, sir?

STATEMENT OF MAX TURNIPSEED, MANAGER, INTERNATIONAL TRADE AFFAIRS, THE ETHYL CORPORATION, ON BEHALF OF THE OFFICE OF THE CHEMICAL INDUSTRY TRADE ADVISOR, WASHINGTON, DC

Mr. TURNIPSEED. Thank you, Mr. Chairman. I appreciate the opportunity to be here this morning on behalf of The Office of the Chemical Industry Trade Advisor.

Our Trade Advisor is Mr. Dexter Baker. He was unable to be here this morning, again, due to some conflict in his schedules and I represent him.

OCITA is a coalition of four trade associations representing the chemical and plastic industries: the Chemical Manufacturers Association, the Synthetic Organic Chemicals Manufacturers Association, the Society of the Plastic Industries, and the National Agricultural Chemical Association. We appreciate the opportunity to be here this morning.

OCITA is here to speak today in favor of the FTA. In February of 1986, before this Committee, we identified about nine priority items that we felt were critical in United States-Canadian trade negotiations under a bilateral context. And we have submitted that for the record, and again today have submitted for the record, as you have noted, our written comments identifying those priorities. And we feel that the FTA does adequately address each of those priorities.

There were not solutions worked out in all areas, but we find that the unresolved issues should not prevent the Agreement from being implemented.

OCITA believes that the FTA will advance the interest of the United States and benefit the U.S. chemical industry. Accordingly, OCITA is pleased to give its unqualified support for the FTA and urges that the Congress approve the necessary implementing legislation.

Now a few comments on these nine priorities I have mentioned.

In the energy area, OCITA is pleased that it provides for unrestricted and secure energy market access, the elimination of two-tier pricing and the prohibition of import and export taxes and fees. We believe it will allow for a greater access to hydrocarbon supplies and improved opportunities for consultation on industry sector disputes that may arise.

On rules of origin, we believe that the rules affecting the chemical products in this agreement will substantially reduce the opportunities for third country imports to receive preferential duty treatment, and that the rules that have been developed are fair and effective.

On tariffs, assuming that the many nontariff barrier issues and obligations under the FTA are met, OCITA finds the tariff eliminations under Article 401 covering chemicals to be acceptable. We are particularly pleased with the consultation provisions allowing for the acceleration of tariff elimination, and we would urge that the Congress put into the enabling legislation appropriate procedures for those consultations. And such procedures, we believe, should require direct private sector initiative and allow only noncontroversial items to be considered for accelerated tariff reduction and elimination.

In the investment area, OCITA had urged that the elimination of all investment restrictions be part of the FTA, but the FTA really does not go that far. The threshold level for the review of direct acquisitions above $50 million Canadian will still affect the majority of the potential investment opportunities in the chemicals area.

Notwithstanding that, the reductions of the existing restrictions and the performance requirements will liberalize the investment policies and enhance freer flow of capital. We hope that the implementing legislation will encourage further negotiation in this area to achieve this unrestricted and predictable investment climate that we had sought in Canada.

In the safeguards area, the dispute resolution area, and the binational panel area, we feel that the rules developed are fair and workable; however, some aspects of these provisions should not be considered as a model for future bilateral trade agreements. We have outlined some specific recommendations on these items in our written statement and would urge those be considered in the implementing legislation.

On the binational panel, particularly, which deals with the antidumping and countervailing duty determinations, we find that that is a creative solution to a very difficult problem area, but we, again, urge that the Congress look at the implementing legislation on the basis of how the private sector can be involved in that process and that the panel must be picked on the basis of their expertise and areas.

Finally, in the subsidies areas, the FTA contains no subsidies provisions on subsidies other than to establish a working group.

And we believe that the implementing legislation should give a specific set of objectives and timetables for this working group and others that may be established under the FTA to that they have some direction for their work.

At this time, we would just again take the opportunity to support the FTA, and we look forward to working with the Congress and the administration on the implementation of this. We hope that these working groups that are intended under the FTA will be addressed in the implementing legislation so that not just the subsidies area but areas like intellectual property rights investment that I have mentioned, and tariffs, can be handled by these working groups as intended in the FTA.

Thank you.

[The prepared statement of Mr. Turnipseed appears in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Turnipseed. I think that you will see in the first two witnesses and you will see it as we continue on these hearings a wide divergence of opinion as to the merits of this particular agreement. And that is what we want to hear about. We want that kind of input so that the Senate, this Committee, and the Congress can be better informed as they arrive at the decision of whether or not to vote for the agreement.

Mr. Schwensen is the Executive Vice President of the National Association of Wheat Growers. Please proceed.

STATEMENT OF CARL F. SCHWENSEN, EXECUTIVE VICE PRESIDENT, NATIONAL ASSOCIATION OF WHEAT GROWERS, WASHINGTON, DC

Mr. SCHWENSEN. Thank you, Mr. Chairman. We appreciate the opportunity to appear before your Committee this morning.

The National Association of Wheat Growers recognizes the importance of United States-Canada trade; however, we do have some serious concerns about several elements of the Free Trade Agreement that has been brought back to the Congress.

Basically, we see no gains for grain growers from this agreement. I might describe a little bit about the grain situation in Canada. In Canada, wheat marketing is controlled by Government monopoly, the Canadian Wheat Board. It is able to employ subsidized rail rates in moving its grain to export positions. Its subsidized rail rates are available within the Canadian marketing system to assist the Wheat Board in moving its grain to export positions. A system of import licensing is in effect which virtually has banned any opportunity for exports to move from the U.S. into Canada.

I might add that in that regard the market that we might have access to under the Free Trade Agreement in Canada is about one-tenth the size of the market that the Canadians will presumably be able to enjoy here in the United States.

Canadian exports historically have not been large, but they have been increasing, and they now amount to about 400,000 tons.

The Agreement imposes a new condition on the use of Section 22, Import Restraints. And I think as we distill our concerns, this becomes our central problem. Section 22 could not be employed under the terms of the Agreement unless there were a substantial change in the support systems either in Canada or in the United States.

Problems are not predictable, but we are concerned that we may not be able to find the type of relief that would be important to us in the event there were to be a surge of imports into the United States, perhaps not generated by a substantial change in support programs.

To its credit, we want to say that the administration has been very careful to listen to our concerns. We have had numerous meetings with them, and we feel that they can make some progress in addressing problems that we have pointed out to them.

We wish, however, that we would have had those same opportunities before the negotiations were completed on the Agreement. We think that our concerns might have been better addressed at that time. And this causes us to think more about the entire fast-track process, and agreements that presumably will be coming back from world trade negotiations to be considered on an expedited basis. And it illustrates I think the importance of communication with the Congress, and access by interested organizations and persons into the negotiations as they evolve.

For that reason, I think that we are somewhat concerned about a disagreement being a prototype for the GATT negotiations because we feel that there could be provisions evolved that are beyond our ability to influence or to respond to. That concludes my comments, Mr. Chairman.

[The prepared statement of Mr. Schwensen appears in the appendix.]

The CHAIRMAN. All right. Thank you. Mr. Benjamin Cooper, Senior Vice President, Printing Industries of America. Mr. Cooper.

STATEMENT OF BENJAMIN Y. COOPER, SENIOR VICE PRESIDENT, PRINTING INDUSTRIES OF AMERICA, INC., ARLINGTON, VA

Mr. COOPER. Thank you, Mr. Chairman, and members of the Committee. I appreciate the opportunity to appear before you today in support of the Free Trade Agreement between the United States and Canada.

The support of the U.S. printing industry for free trade with Canada is not a new issue. We have been supporting free trade with Canada for the past 20 years. It is no wonder that we support such an agreement since over half of all U.S. exports in printing go to Canada.

In 1987, the United States exported $750 million in printed products to Canada. It becomes even more obvious when one realizes that the trade barriers imposed by Canada on printed products defy description. The following is a capsule of the barriers we face.

In tariffs, the tariffs on printed products are the highest of all Canadian tariffs, with the highest being a 28.6 percent tariff on catalogs, followed by a 24.3 percent tariff on advertising products.

In postal rates, magazines and newspapers printed in the United States but mailed in Canada pay postal rates up to six times the rate paid by publications printed in Canada.

In addition to these restrictions, U.S.-printed publications containing more than five percent of its advertising content directed at a Canadian audience are prohibited from entry into Canada.

The United States maintains no restrictions even remotely similar to these barriers. We have no tariffs on catalogs. Our advertising tariff is 4.9 percent among our highest tariffs, and the only nontariff barrier in the U.S. to printed products is a prohibition on the import of lottery tickets printed outside the United States.

Essentially the U.S. printing industry has achieved free trade. We are merely waiting for Canada to join us.

Clearly, the approval of the Free Trade Agreement is beneficial to the U.S. printing industry. Under the Agreement, all tariffs would be eliminated in 5 years. By our estimates, approximately $500 million in new business could be made available to U.S. printers if these restrictive tariffs were eliminated.

In view of the fact that U.S. printers exported this $750 million in 1987 to Canada, such an increase would be tremendous.

As pleased as we are with the overall achievements for the U.S. printing industry with the Free Trade Agreement, we regret that more progress was not made with regard to nontariff items. The discriminatory postal rates and import prohibitions will continue after the signing of the Agreement. Regrettably, the barriers to trade are covered under that enormous umbrella known as "cultural sovereignty."

In the negotiations, Canada evidently accepted the U.S. printing industry's argument that printing is not a cultural industry, but would not go so far as equating postage rates and advertising restrictions in printing. Instead, these apparently were viewed as publisher issues.

It is true that publishers are affected by the restrictions, but the prohibitions themselves primarily related to the place of printing.

Despite these restrictive tariff and nontariff barriers, the U.S. printing industry has managed to maintain a favorable balance of trade with Canada for a number of years.

As the material accompanying this testimony indicates, the favorable balance has been in the area of books and periodicals. It should come as no surprise that these are also the area where there are no tariffs. These are clearly major product areas for the U.S. printing industry, but the key statistics review are the negative balances in catalog and the all-printing categories which is the heart and soul of the U.S. printing industry.

Advertising printing represents 30 percent of the U.S. industry and catalog printing represents 14 percent, compared to magazines, at 17 percent, and books, at 5 percent. Yet, our exports in these areas are limited.

We believe these limitations are due almost entirely to the excessive Canadian tariffs on catalogs and advertising material.

As stated in the beginning of the testimony, the U.S. printing industry is strongly supportive of this Agreement. Our efforts to achieve freer trade with Canada have included legislative attempts to remove barriers or to raise ours to an equivalent level. Additionally, in 1987, the Printing Industries of America drafted a Section 301 petition against Canada, specifically naming the trade barriers listed in the earlier part of the testimony. We never filed that petition, instead, preferring to work within the context of the Free Trade Agreement.

If this Agreement is not approved, we will have to reconsider whether to file that complaint. Regardless of the outcome of the Agreement, we must also consider whether it will be necessary for us to proceed with the 301 petition to attempt to have the other barriers removed.

We would hope the Congress would seriously consider continuing to work with Canadian officials to address, in particular, the postal rate issue. Clearly, the U.S. Postal Service has problems with revenue, and yet we do not punish foreign printers and publishers who wish to mail in this country.

In conclusion, we urge your support and prompt ratification of the Free Trade Agreement. The fact that we are unhappy with aspects of the Agreement is part of the give and take that goes into any negotiations. We ask, too, that as you consider the outcome of this matter, you look to industries such as printing. Industries such as ours pay little attention to international trade. With few exceptions, our members know little about export. They only know that they see Canadian printers competing for work that they have been doing. They do not mind the competition; they are used to it. However, they object when they have no opportunity to compete for work in the country of the competitor.

Thank you very much.

[The prepared statement of Mr. Cooper appears in the appendix.]

The CHAIRMAN. Mr. Gundersheim, how do you pronounce your name, sir?

Mr. GUNDERSHEIM. Gundersheim, sir.

The Chairman. Gundersheim. Thank you.

As I understand the Canadian duty remission on textiles, which concerns all of us because it seems inconsistent with the spirit of the Free Trade Agreement, the Canadian Government would increase the incentives for exporting denim to Canada from the United States and only the United States. Now why isn't that aspect of the program good for American producers?

Mr. GUNDERSHEIM. Well that part of the Agreement probably is good for American producers, but I don't see how that would affect trade very much anyway because the majority of Canadian denim now comes from the United States anyway. The United States is by far the most efficient and highest quality denim producer in the world. And, essentially, I don't see in that single aspect that it would make that much difference, quite frankly.

The CHAIRMAN. I notice I did not call on one witness. I apologize to you, Mr. Cooperman. Mr. Cooperman is the Executive Director of the Independent Zinc Alloyers Association. Would you proceed, please?

STATEMENT OF R.M. COOPERMAN, EXECUTIVE DIRECTOR, INDEPENDENT ZINC ALLOYERS ASSOCIATION, WASHINGTON, DC

Mr. COOPERMAN. Thank you, Mr. Chairman and members of the Committee. We appreciate the opportunity to appear before you today.

The FTA is a bilateral document between two strong allies. However, to our other allies and to the rest of the world, it can be viewed as a unilateral action and a signal to developing countries that the United States-Canada bloc can become largely self-sufficient in natural resources, production, consumption and trade. The FTA could be a step toward the economic isolation of a United States-Canada. The case in point is the tariff section of the Agreement.

As tariffs between the two nations dwindle, and trade between our two countries intensify, the tariffs of the United States and Canada will continue to stand against the rest of the world. U.S. companies that rely upon foreign resources for raw materials, like the alloys, will look only to Canada because of advantageous prices as a result of fallen tariffs. Sources outside the FTA will be kept out by our joint tariff walls.

Eighty-five percent of domestic producers' zinc consumed in the United States must be imported. Sixty percent of this comes from Canada. As a result of the FTA, Canadian zinc producers may have a double incentive to market zinc alloy in the United States and displace our domestic zinc alloy industry.

As the 19 percent ad valorem duty on zinc alloy falls, they may wish to take advantage of their substantially lower production cost to compete with U.S. Independent Alloyers. Second, other foreign supplies that produces zinc may not be able to compete in the United States at the Canadian price, plus a duty the Canadian companies will not need to pay.

There could be a shortage of imported-producer zinc for these zinc alloys, and Canadian producers would have to supply zinc alloy to the U.S. to make up any shortfall. In either event, U.S. Independent Zinc Alloyers would lose their markets to Canadian companies who then would have the benefit of the 19 percent duty against the rest of the world.

The Economic Council of Canada, a Crown corporation, whose members are appointed by the Prime Minister, has just published the results of a study titled "Management Adjustment," policies for trade-sensitive industries. It is intended as a guide for governments. A brief paragraph at the opening of the study states: "The purpose of this study is not only to assess the amount of change that has taken place, but also to examine the appropriate role for governments in fostering adjustment and in moderating its more painful side effects."

The report also says: "Quota restraints provide both labor and capital with time to adjust. To the extent that an import surge is likely to cause serious injury, there is a rationale for giving industry a breathing space in which to adjust."

Consequently, the Canadian report says: "We support the use of quotas to assist industries adversely affected by international competition."

Canada already has launched this policy. It has circumvented the FTA by restricting exports from the United States of ice cream, ice milk, yogurt, skim milk and buttermilk. In effect, Ottawa placed a quota on certain dairy products to protect its domestic industry from any forthcoming U.S. competition. And we are all aware of their recent actions on textiles.

The Prime Minister of Canada and his government advocate the broadest possible free trade arrangement between our countries. Nevertheless, the Economic Council of Canada, appointed by the Prime Minister, publicly recommends the use of quotas to assist Canada's trade sensitive industries. And they have already used them in anticipation of the results of the FTA.

Mr. Chairman and members of the Committee, I urge you to consider in the enabling legislation corresponding measures to assist U.S. import sensitive industries like the Independent Zinc Alloyers.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Cooperman appears in the appendix.]

The CHAIRMAN. Thank you, Mr. Cooperman.

Mr. Turnipseed, we have heard from a number of chemical companies with deep concern about Canada's lack of protection for intellectual property rights and, in turn, about their subsidies for their exports on chemicals. Is your advisory group satisfied on those two points? And let me ask you, do you have the united support of the chemical companies for your point of view?

Mr. TURNIPSEED. Yes. Let me answer both your questions, Mr. Chairman. First, on the intellectual property rights, we are completely united in that position. I did not dwell on the intellectual property rights in my oral statement here. It is detailed in our written statement. We are very concerned that the U.S. and Canadian FTA did not specifically come up with a provision for intellectual property rights other than dealing with it under the Uruguay Round. And I would hope that there would be some sort of a commitment that the U.S. could persuade Canada to come to as well to further negotiate intellectual property rights on a bilateral basis because we are not satisfied that intellectual property rights will be dealt with well enough and soon enough in the Uruguay Round. So that is of major concern to us.

The CHAIRMAN. Well do you think you could make much headway in a bilateral negotiations if this Agreement has already been put into effect? Do you think you have much leverage left?

Mr. TURNIPSEED. We think there is some leverage left, because the laws of both countries, at least in the areas affecting chemicals, are not that dissimilar, and many of our laws are almost identical. So it is not a matter of starting from an uncommon point, so to speak.

They did make some headway in certain patent laws in the pharmaceuticals area and the compulsory licensing area outside of the Free Trade Agreement, and we do think there is a common ground there.

On subsidies, we are, as I noted, unhappy that subsidies were not dealt with. And that is the reason we would urge for these working groups that are intended to try to work on the subsidy area to be given some more direction so that they can come up with maybe a workable definition of what is an actionable subsidy. And then if one employs that actionable subsidy, what sort of remedy or compensation the other party is due.

The CHAIRMAN. Thank you.

Mr. Schwensen, the current law requires that the administration on a trade agreement like this consult with industry to see how it might affect them, what their concerns are. Did the administration consult with your association?

Mr. **Schwensen**. Not in any formal sense, Mr. Chairman.

The **Chairman**. What does that mean? Tell me.

Mr. **Schwensen**. Well, no.

We do have representatives as part of the Technical and Policy Advisory Committees which were established by the Agriculture Department and the Office of the Special Trade Representative, but otherwise, we have communicated during the course of the negotiations by letter with the Agriculture Secretary and the Special Trade Representative indicating our concerns as the negotiations began to make progress.

The **Chairman**. Well, did you think there was a satisfactory exchange of opinions and concerns?

Mr. **Schwensen**. I don't mean to say that we are totally dissatisfied. My concern is that while I think that we were carefully listened to, that our concerns, nevertheless, were not dealt with adequately in the final negotiation. I think we did our job in trying to indicate problem areas.

The **Chairman**. The problem we have, Mr. Schwensen, is that it is a lot tougher after you progress this far to start changing the Agreement. You don't have that much wiggle room left. And trying to stay within the objectives of what has been agreed to and still try to make adjustments is not that easy. Thank you.

Mr. Cooper, actually you are a part of a chain of industries, are you not, as I understand it: paper, ink, advertisers and writers, all of whom have some problems with Canadian trade barriers?

Not taking all of those industries into account, you can lump them together, do you think they are going to be better off or worse off if this Agreement goes into effect in its present form?

Mr. **Cooper**. We are clearly better off.

The current situation is that we have virtually no tariffs, no barriers at all. And we have been facing—and this has been the situation for a number of years—and we face substantial barriers in Canada. So for us, the idea of eliminating tariffs in 5 years is going to be 180 degrees different from the way it is now. There is no question we are better off.

The **Chairman**. Cooperman, as I was listening to your testimony, it sounded to me like what you are really trying to do is get an exemption for zinc alloy from the Canadian Agreement. If that is what you are asking, we have got a whole list lined up that wants that. How do you think we can do that?

Mr. **Cooperman**. Mr. Chairman, in our repeated meetings with the U.S.T.R., they indicated to us that if any exemptions were granted to any industry they would talk to us along the same line.

The **Chairman**. What does that mean: They would talk to you along the same line?

Mr. **Cooperman**. They would talk to us about an exemption for our industry.

The **Chairman**. They didn't say they would give you one. They said they would talk about it. Is that it?

Mr. **Cooperman**. That is correct, sir. We are exempted from the last GATT round, the so-called Tokyo GATT round. When the fisheries industries were taken out of the Agreement, we tried again to open communications with the U.S.T.R. on the basis of their promise that they would get back and talk with us if there were any other exemptions, and we have never been able to reopen dialogue with them.

The **Chairman**. Thank you very much. I see my time has expired. Senator Packwood.

Senator **Packwood**. Mr. Gundersheim, as I look at the list of witnesses across here, we have got chemicals and printing that say, on balance, is all right. We have got some things we do not like, but, on balance, it is all right. And you have got zinc, and wheat, and textile and apparel saying, well, on balance, we do not like it. How should this Committee look at it, and the Congress? Should we say, well, on balance, it is better than worse for the country, even though it may hurt the textile and apparel industry? Or do we almost go down industry by industry, and if it is not good for all of them, we turn it down.

Mr. **Gundersheim**. It seems to me that, first of all, my obligation is to speak for the workers I represent. In that sense, it is very clear in terms of our presentation. And, in total, we think the Agreement has more negative than positive aspects to that.

If you are asking me to the Agreement as a whole, quite frankly, I think the precedence set in this Agreement on the antidumping and the countervailing duty questions on some of the other issues that could serve as a precedence for GATT, I think, on balance, it probably would turn us against this Agreement in total.

Senator Packwood. In total?

Mr. **Gundersheim**. Yes.

Senator **Packwood**. Mr. Schwensen, what do you think in response to the same question? Where should we come down? Should we have to make sure this Agreement favors every industry that is concerned, or, on balance, do we just say there are 60 winners and 40 losers, and, on balance, it is better for the country?

Mr. **Schwensen**. I think you have to look at the balance that it achieves for the country, Senator. The concerns that we have had I do not believe are going to be adequately dealt with. We see hypothetical problems. We are not certain that we are going to suffer future damage. We just feel that there is the potential for our industry to experience some heavy imports from Canada which were going to disrupt our prices and also disrupt our domestic marketing program.

Senator **Packwood**. What do you think, Mr. Cooperman?

Mr. **Cooperman**. Mr. Packwood, I believe that, on balance, we have now put ourselves in a position of instead of relying upon an equitable swap resources and production between the two countries, we are creating a possibility of isolating ourselves from the rest of the world when the duties go into effect, and other countries cannot sell to us the materials we must have because they are the disadvantaged in terms of the falling duties between the United States and Canada.

I think the natural resources aspect of this Agreement are not in the best interest of the United States and not in the best interest of Canada either.

Senator **Packwood**. If we were to conclude that the natural resources part of this Agreement does not benefit Canada or the United States—although I suppose from a Canadian standpoint that is their judgment to make—but the rest of the Agreement does, which way should we go?

Mr. **Cooperman**. I would have to be parochial, Senator and say go against it.

Senator **Packwood**. All right.

Mr. **Cooperman**. Natural resources are too much of a part of this world.

Senator **Packwood**. That is a fair answer. I understand who you are representing. And is it fair enough to say that we will have to make a decision based on a broader basis than that?

Mr. **Cooperman**. Yes, sir.

Senator **Packwood**. Now, Mr. Schwensen, let me ask you a question because you referred to it once in your testimony and then again just now. You talked about, I think, 25 million people in Canada and 250 million people here, and they will have access to this tremendous market, and all the American wheat people will have is access to the Canadian market. Assuming that you knock down all the barriers, do I paraphrase roughly what you said?

Mr. **Schwensen**. Yes. And assuming that subsidy systems between the two countries at some point become equalized—that is another term of the Agreement—so that there is no automatic access when the Agreement goes into place, there are still conditions that have to be met before U.S. producers or manufacturers would have the opportunity to sell in Canada.

Senator **Packwood**. Now assuming that those hurdles are overcome, do you have any fear about opening up a U.S. market 10 times as big as the Canadian market to Canadian production? And, Lord knows, they are good wheat producers; they have good land. Whereas, we would only have access to a market of 25 million. Does that bother you? Assuming all other things being fair.

Mr. **Schwensen**. Yes. I think that is fundamental to our concerns. The dislocations could likely be regional rather than national. It would depend upon the extent of which political decisions in Canada were made to export sizable quantities of wheat to the United States.

Senator **Packwood**. I am not talking about export subsidies. I am asking just from the standpoint of our market and their market. Assuming you reach a place where there are no export subsidies and no growing subsidies—because the same question could be asked of any industry; Canada gets access to 250 million people; we get access to 25 million people—how is the U.S. wheat industry going to accommodate to that, or any other U.S. industry when suddenly you can be faced with a glut of legitimately produced unsubsidized wheat or any other product that has not been allowed in here on an unrestricted basis before?

Mr. **Schwensen**. Well that is our concern, Senator, is how do we deal with that if that were to occur? We have a different marketing system than the Canadians have. They have essentially a government monopoly. We have boards of trade. We have a different grading system than they have. So I think it is going to be very, very difficult to see the two grain economies integrated to any workable degree.

Senator PACKWOOD. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you. Senator Mitchell.

Senator MITCHELL. Thank you, Mr. Chairman. Mr. Cooper, I was very much interested in your statement in which you identified three barriers that your industry currently faces. And you described, in addition to tariffs, postal rates, and you said that magazines and newspapers printed in the United States but mailed in Canada have postal rates up to six times the rate paid by publications printed in Canada.

Mr. COOPER. Yes, sir, that is correct.

Senator MITCHELL. So that if something is printed in this country but mailed in Canada, the Canadians require the rate to be paid higher than a comparable product printed in Canada?

Mr. COOPER. That is correct. Essentially, they have three rate structures for publications. A domestically-owned, domestically-printed rate; a foreign-owned domestically printed rate; and a foreign-owned foreign-printed rate. And the foreign-owned foreign-printed rate is the one that is roughly six times greater than the domestic-owned, domestic printed rate.

Senator MITCHELL. And are these discriminatory postal rates affected by the Free Trade Agreement?

Mr. COOPER. No, they are not. As a word of explanation, in the initial announcement of the Free Trade Agreement, it was announced that discriminatory postal rates would be removed. There was some negotiation still going on at that time, unfortunately. And that negotiation centered on a phrase of "substantial circulation publications."

Canada has subsequently agreed that they would allow those discriminatory rates to be removed for "substantial circulation publications." We then got to talking about what is substantial. We thought perhaps a thousand would be substantial. We were off by 99,000. They thought 100,000 should be substantial, which would have exempted three titles in Canada.

Senator MITCHELL. Now there is no comparable provision under American law?

Mr. COOPER. No, sir.

Senator MITCHELL. So this is plainly a discriminatory practice aimed at publications printed outside of Canada?

Mr. COOPER. Clearly.

Senator MITCHELL. And with respect to the third category, import restrictions, you state that U.S. printed publications containing more than 5 percent of its advertising content directed at a Canadian audience may not be brought into Canada.

Mr. COOPER. That is correct.

Senator MITCHELL. Is it flat prohibition against it being shifted in there?

Mr. COOPER. That is correct.

Senator MITCHELL. And there is no comparable provision in the United States?

Mr. COOPER. No, there is not.

Senator MITCHELL. And is this restriction affected by the Free Trade Agreement?

Mr. COOPER. No, it is not.

Senator MITCHELL. Have you asked the American representatives, or the Canadian representatives, how can these obviously discriminatory practices, which are the very opposite of free trade, be justified in the context of a Free Trade Agreement?

Mr. COOPER. We asked the question repeatedly. I must say from the standpoint of U.S. negotiators that those were, particularly the postal rate issue, priority objectives that were not achieved. As I mentioned in my testimony, we drafted a 301 petition dealing with those two subjects. And depending on how the final shape of the Agreement—I am assuming these items will not be contained in the final Agreement—we may yet have to file that petition to get relief on those two items.

Senator MITCHELL. Are you aware of the Canadian law which provides that expenditures made by Canadian companies advertising in the United States, even though directed at Canadian citizens——

Mr. COOPER. Yes.

Senator MITCHELL. ——may not be deductible for tax purposes.

Mr. COOPER. Yes, we are.

Senator MITCHELL. Well I would like to ask you to submit to me and the Committee in writing any suggestions you have with respect to implementing legislation which we might attempt to deal with this. These seem clearly incongruous—in my judgment, another example of where our negotiators failed to achieve anything that proved difficult with respect to Canadians. The best example, of course, is the Canadian success in permitting subsidies to be unaffected by this Agreement, which causes serious problems for several American industries, particularly some in my State. That is unrelated to you. And I would like to have you submit in writing any suggestions you have for implementing legislation which we might be able to deal with this. I don't know whether we can because, of course, the legislation cannot directly contradict the Agreement.

Mr. COOPER. Senator Mitchell, if I may, if I understand the Canadian postal rate structure properly, they regard the differential in postal rates as a subsidy to domestic printers and publishers. In other words, if postal rates were equalized under Canadian postal rate circumstances, what would happen is the Canadian postal rates would rise to the level charged U.S. printers and publishers.

Senator MITCHELL. All right.

Mr. COOPER. Rather than the other way around.

Senator MITCHELL. So it is a subsidy issue.

Mr. COOPER. I think they regard it as a subsidy issue. We regard it as a postal rate issue.

Senator MITCHELL. My time is up. So could I ask just a couple of questions and ask that the answers be submitted in writing, Mr. Chairman?

The CHAIRMAN. Sure.

Senator MITCHELL. Mr. Gundersheim, I would like to ask you to submit a similar response. I understand you oppose the agreement, but give us some specific suggestions for improving it.

And, finally, I would like to ask each witness to comment, in writing, to the Committee on the extent to which you felt you were consulted meaningfully during the course of the negotiations, and whether, in light of your experience, you continue to favor the fast-track mechanism which does not permit amendments to agreements of this type. I am personally troubled by that. I think some other members are. That we get ourselves in a situation where the premise on which we proceed on a fast-track is that there will be meaningful prior consultation. In fact, it is not meaningful where it occurs at all, and then we are left with an up or down vote on something we cannot change. And I would like to get your industry's experiences and your comment on the fast-track mechanism as a result of those experiences.

Thank you, Mr. Chairman.

The CHAIRMAN. Thank you, Senator. Senator Baucus.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. Thank you, Mr. Chairman.

Gentlemen, I think we all understand that countries will do what they can to protect their industries and their economic livelihood. Our country has tended to utilized tariffs and quotas as a way to protect certain industries historically, but Canada has tended to now follow that route but rather subsidize their industries.

In fact, the OECD studies this matter and has concluded that the United States expends about one-half of 1 percent in 1980 in subsidizing this industry; whereas, Canada has spent that same year for which we have figures 2.5 percent of its Federal budget subsidizing its industries, a ratio of 5 to 1 to which Canada's Federal budget subsidizes its industries more than does the U.S. budget.

At the same time, this Agreement tends to be a tariff reduction agreement. It is not a subsidy reduction agreement. So when you add it all together, the bottom line is that this agreement tends to favor those industries that Canada Subsidize very much at the expense of our industries, and as you have pointed out to some degree, Mr. Cooper, tends to favor those American industries of which have relied only upon tariffs. That is, Canada reduces its tariff, as it has to some printing industries, that helps the American, those industries in America.

And a good example of this is wheat. The administration, however, sometimes says that we Americans subsidize our wheat industry more than do the Canadians subsidize theirs. I have heard that statement.

I would like to ask you, Mr. Schwensen, whether you agree with that. And if you do not agree with that statement, could you give us an example of where your judgment anyway the Canadians subsidize wheat more than do we Americans subsidize wheat.

Mr. SCHWENSEN. Well, clearly, Senator, subsidies exist in both systems. The systems are different. So our subsidy mechanism is very visible. Our programs are operated in full public view. The extent is assistance to farmers and other agricultural industries.

Senator BAUCUS. Would you give some examples though where Canada does, in effect, subsidize, some examples that are not generally well known?

Mr. SCHWENSEN. Well, the most prominent one from our vantage point is the Western Canadian Grain Rail rates which amount to a subsidy on the movement of grain of 50 cents per bushel, which is very significant, particularly in view of the fact that we have seen some very sizeable increases in our rail rates here in the United States just this year.

Additional subsidies are—there are subsidies to crop insurance in Canada as there are subsidies to crop insurance here in the United States. Implicit in operation of the Canadian Wheat Board, we believe are subsidies because the contract prices are not disclosed. The trading does not take place in a public forum. So we think that there is a very strongly implied subsidy just through the nature of their marketing system.

Senator BAUCUS. Does the American satisfied CRT program also tend to reduce American subsidies in wheat production?

Mr. SCHWENSEN. Oh, absolutely.

Senator BAUCUS. Could you explain that a little more fully, please?

Mr. SCHWENSEN. Well, as a requirement for qualifying for Federal farm program benefits, growers of grain and other commodities in the United States have been required to lay out a certain percentage of their production base. This has had the effect of reducing the amount of subsidies to them directly. Also, it increases the—well, it reduces individually the subsidies to them. It can stand to increase their individual production cost. But it conveys a benefit not just to U.S. producers but to Canadian producers and producers worldwide. And as much as we have taken an independent adjustment action, it has not been mirrored by any other competitor.

Senator BAUCUS. I would like to follow up a little bit on an excellent question Senator Mitchell asked, that is, the degree to which you recommend the fast-track process be changed because you were not adequately consulted. I would give that to anyone who feels that his industry was not adequately consulted and who might have some suggestions as to how we might change the law here. Anyone. Yes.

Mr. GUNDERSHEIM. Senator, I would suggest one thing, that consultations and dialogue are two very different concepts. There was never any question, at least on the textile industry, on our part, of being able to reach the chief negotiator and discuss the issues with him. The issue was listening, accepting our recommendations, or at least some discussion of the substance of the recommendation. And, quite frankly, in the end several aspects of the Agreement that dealt with textiles came as a complete surprise in terms of the magnitudes.

For example, the differential between Canada and the United States in terms of the reduced duty and duty-free portions of the Agreement in the 5 to 1 ratio came as a total surprise to everybody on this side.

Senator BAUCUS. Thank you.

The CHAIRMAN. Senator Daschle.

OPENING STATEMENT OF HON. TOM DASCHLE, A U.S. SENATOR FROM SOUTH DAKOTA

Senator DASCHLE. Thank you, Mr. Chairman.

I would like to follow up a little bit on Senator Baucus' question. My concern is really a definitional one, to begin with, and that is the real concept of a free trade agreement. In Max's testimony I think there was a question relating to tariff reduction and subsidy reduction. Can we really have a free trade agreement by dealing with tariff reduction and not subsidy reduction? I think there is the best case to be made in trying to answer that question when related to agriculture.

Senator Baucus had asked you, Mr. Schwensen, a question relating to Canadian subsidy, and especially as it relates to agriculture. The producer's subsidy equivalent calculation has determined that Canadian subsidy is set at a lower rate than U.S. subsidy overall.

First of all, I would ask how the wheat growers specifically challenge that conclusion? Second, I would like you to address if you could the notion that if indeed that is the case, and we give up more subsidization with regard to agricultural products than they do, and we do not address transportation subsidy or the other kinds of subsidies that exist outside of agriculture, do we not then leave ourselves in an even more vulnerable position? If you could address both questions. First, the calculation itself; second, the vulnerability as a result of divorcing that question from transportation subsidy itself.

Mr. SCHWENSEN. Yes, Senator Daschle.

I am not expert on the calculation of the producer's subsidy equivalent. I do think that the administration to its credit after the negotiations were concluded did work very closely with the Canadians and came up in the appendix of the agreements with the methodologies for determining TSEs. It is not a perfect measurement, however. And you are indeed right. It is my understanding that the finding was that the American wheat producers subsidize to a greater extent than the Canadian wheat producer under that calculation. The calculation, however, does not at all as I know it. I deal with such factors as currently relationships and the like. That is probably one of the more outstanding defects in that approach.

As I followed the negotiations, we were told that exceptions, such as rail subsidies, which we had recommended that our government make progress on, our government found that the negotiations did not lend themselves to progress in that area. And it was decided that issues such as rail subsidies would be rolled into the GATT negotiations and dealt with in that context.

Senator DASCHLE. Let me just ask you a follow up question, and then I would like to ask the group, or anyone, to respond.

Let's assume, getting back to the second part of my two-part question, that we do eliminate agricultural subsidies on both sides. We still then contend with what you describe as a 50-cent per bushel transportation subsidy that is not affected by this agreement. What would be the impact on American wheat sales if that transportation subsidy was maintained over, let's say, a 2- or 3-year time frame?

Mr. SCHWENSEN. I think it could be rather significant because our rates are going up while the Canadian rates remain stable. Therefore, there is a clear competitive advantage in terms of the export market and an advantage in exporting to the United States as well.

Senator DASCHLE. In dealing with competition, could you just describe for the Committee how narrow sometimes a competitive edge can be for a large market sale? Isn't it true that in some cases it is a matter of a few pennies per bushel?

Mr. SCHWENSEN. Certainly it is. And transportation has a lot to do with the final contract that is concluded. And since there are advantages by where you locate the grain for sale, there can be benefits very directly derived from rail subsidies.

Senator DASCHLE. We have no subsidy in transportation in this country. Is that not correct?

Mr. SCHWENSEN. That is correct, Senator.

Senator DASCHLE. Could I, for the record, then, Mr. Chairman, ask the group if they could just respond to my initial question. In the view of these organizations, is it possible to have what we would term "free trade" generically with tariff reduction with no regard for subsidy reduction? I would be interested in your answers.

Thank you, Mr. Chairman.

The CHAIRMAN. That's fine. We will do that for the record. Thank you, Senator. Senator Roth.

OPENING STATEMENT OF HON. WILLIAM V. ROTH, JR., A U.S. SENATOR FROM DELAWARE

Senator ROTH. Thank you, Mr. Chairman.

Mr. Turnipseed, in your testimony you have some dissatisfaction with respect to intellectual property. On this issue you state that you think it is important that there be a U.S. commitment, a negotiated substantive intellectual property agreement with Canada in future bilateral negotiations. Like you, I think intellectual rights are extraordinarily important in this technological revolution. And I am concerned not only with what the problems may be in Canada, but elsewhere as well.

One of my questions to you is why do you think the intellectual property situation with Canada is not adequate? What is peculiar about Canada that we should not go full speed ahead in the multilateral negotiations? In other words, I think there are other countries where the problem is very important as well. Would you explain your position?

Mr. TURNIPSEED. Senator Roth, let me clarify that. We did not mean to say that we felt that the situation was necessarily different in Canada as in other parts of the world. We would encourage multilateral, in fact, very strongly support multilateral approach to intellectual property. But I think what we were trying to say is that we had looked to the Canadian FTA, the Free Trade Agreement negotiations, as maybe setting a precedent or a model that could be built upon in the multilateral context, and, therefore, that is why we were quite disappointed. And we still feel that if there can be some commitment made to go on with some future negotiation with Canada in intellectual property it still may set the stage for a better multilateral context.

Senator **Roth**. But you would urge that we proceed very aggressively in the GATT negotiations as well.

Mr. **Turnipseed**. Yes, sir, I sure would.

Senator **Roth**. Could you explain a little better for us what the problem in respect to Canada is? Now have they taken care of the situation on mandatory licensing in the area of pharmaceuticals?

Mr. **Turnipseed**. With respect to the compulsory licensing on pharmaceuticals, they have. Not in the context of the Free Trade Agreement, but under a separate patent law. I believe 22 was their law number for that.

Senator **Roth**. There are other agreements. I mean, their basic patent law is compatible with the United States?

Mr. **Turnipseed**. Very compatible. Most of our laws are very compatible.

Senator **Roth**. Now how about in the area of copyright?

Mr. **Turnipseed**. Copyrights. I am not really competent to speak in that area. I would be happy to submit something for the record. It is my understand that they are not comparable.

Senator **Roth**. Mr. Chairman, I would request that Mr. Turnipseed does provide that for the record. I would also appreciate any written comments on the need of a bilateral reservation.

Mr. **Turnipseed**. All right, sir.

Senator **Roth**. Thank you, Mr. Chairman.

The **Chairman**. Senator Matsunaga.

OPENING STATEMENT OF HON. SPARK M. MATSUNAGA, A U.S. SENATOR FROM HAWAII

Senator **Matsunaga**. Thank you, Mr. Chairman.

Well, having so many of the members of the panel ask questions ahead of you, of course, leaves you with very few questions to ask which have not already been asked. But, generally speaking, I take it that all of you here are opposed to the Congress' approval of the FTA between the United States and Canada. Do I get you correctly? No? I see you are shaking your head, Mr. Cooper.

Mr. **Cooper**. I think we have a three to two vote here.

(Laughter)

Mr. **Cooper**. Two for; three against.

Senator **Matsunaga**. Mr. Cooperman?

Mr. **Cooperman**. We would be opposed, Senator Matsunaga.

Senator **Matsunaga**. And Mr. Schwensen?

Mr. **Schwensen**. We are hoping that we do not have to oppose the Agreement. We hope that in the implementing legislation and in further discussions with the administration that our concerns can be dealt with, if not in whole, at least in part.

Senator **Matsunaga**. So that you are hopeful that the implementing legislation will take care of the problems which you now see?

Mr. **Schwensen**. Yes, sir.

Senator MATSUNAGA. And as you know, under the fast-track trade procedure the administration is expected to submit its legislative proposal about June 1st. And do you feel that you are in a position to deal with the administration to the extent that they may alter their present general proposals to meet your requirements?

Mr. SCHWENSEN. No, Senator, I don't believe we are in that position at all. And that is not the way I understand the fast-track to operate. But we do hope that we are in a position with the administration that we can work with them in finding some details in the implementing legislation that could not provide protection that we seek but to give us some assurance that in the future that we will be able to use some trade devices to protect us against a surge in exports from Canada.

Senator MATSUNAGA. Mr. Turnipseed?

Mr. TURNIPSEED. The chemical industry does support the Free Trade Agreement, Senator. However, we do urge that this implementing legislation does take an opportunity to set up some objectives for this working group on subsidies that has been identified in the Agreement. Other areas that have been noted in the Agreement that they intend to have ongoing negotiations, they have not stipulated within the Agreement that a similar working group and a set of guidelines like they did for subsidies. They have no provisions like 1907 of the Agreement.

So we believe that it is possible for the Congress to put that sort of language in the enabling legislation so that at least some ongoing negotiations can take place in those areas where we think progress can continue to be made.

Senator MATSUNAGA. What about the binational panel which is expected to be set up? Don't you feel that that binational panel whose decisions will even go beyond whatever the court decisions have been, don't you feel that such a binational panel will be able to take care of the problems that you have?

Mr. TURNIPSEED. No, sir, I do not. The binational panel is more set up to handle only the antidumping and countervailing duty terminations.

Senator MATSUNAGA. So your problems go beyond that.

Mr. TURNIPSEED. Yes, sir.

Senator MATSUNAGA. Mr. Gundersheim?

Mr. GUNDERSHEIM. Unfortunately, I don't see any way the implementing legislation or any potential changes in the negotiations can modify, one, what has been negotiated in terms of the textile apparel area, and, second, see any significant change in the Canadian Government's duty remission scheme that gives a very clear competitive advantage to the Canadian side.

Senator MATSUNAGA. Well thank you all. Generally, I have been a free trader, but what Canada has done to export sugar to the United States has caused me some concern about how Canada has been operating. And I can understand your problems because as several of you may know, we have a quota on sugar imports, and Canada mixes sugar with wheat and other products to the United States. And, of course, hopefully, this Agreement will take care of that problem because I serve on this Committee. (Laughter)

Well I see my time is up. Thank you, gentlemen, for your views.

The CHAIRMAN. Thank you, Senator. Senator Riegle.

OPENING STATEMENT OF HON. DONALD W. RIEGLE, JR., A U.S. SENATOR FROM MICHIGAN

Senator RIEGLE. Thank you, Mr. Chairman.

I want to raise the issue of the zinc alloy industry problem because that is certainly one area that is seriously impacted by the Free Trade Agreement.

According to Marvin Fink, who is an alloyer who recently testified before the Ways and Means Committee, in his view as one witness, our domestic industry is really threatened with extinction by the provisions as they stand today.

Now zinc alloying is not one of the giant industries of our nation, but is certainly by any standard a Vital industry. And especially if we want to stay in the manufacturing game globally and in the high technology manufacturing area, it is very important to us I think from a strategic point of view. We are down to 26 alloyers in 10 States. Those States are well represented on this Committee. In Michigan, we have four remaining; in New York, five; Pennsylvania, two; Colorado and Kansas each have one. But the total elimination of all the tariffs on zinc alloy I think genuinely threatens to put most of these companies out of business within a 4-year period of time. And although the industry is in the 10-year tariff phase out, Canada will, by its own admission, begin to export zinc alloy into the U.S. to avail itself to the U.S. market and the protection it affords them from foreign producers of zinc alloy.

During the negotiations on the Agreement I made suggestions to mitigate the damage to the industry once it became clear that an exemption from the tariff elimination was not being considered by our negotiators.

I would ask that the rest of my statement be made a part of the record.

Mr. Cooperman, why do the independent zinc alloyers believe that the Canadian zinc producers want to take over the U.S. market?

Mr. COOPERMAN. Senator Riegle, once the duties begin to fall below a certain level, the Canadian zinc producers, which are really world-sized companies—easily, 100 times larger than any alloyer—can at a Very low cost produce zinc alloy, sell into the United States well below our price. That could begin really in the fourth year of the phase down of the tariff.

Senator RIEGLE. Under the Free Trade Agreement, duties on zinc alloy are phased out over a 10-year period of time. Tell me exactly why 10 years, in your view, is not enough to adjust to the elimination to duty.

Mr. COOPERMAN. For one thing, the alloyers are bankers to their customers, the die casters. They have to carry a great deal of inventory. Once our bankers become aware of the fact that we are going to be phased out of the business and challenged severely by very large Canadian companies, we will lose our ability to borrow. We will stop all research and development work. We will not improve our production capabilities. We won't have the capital to do it. And it becomes a matter of losing our ability to finance both continuing operations and certainly any expansion or improvement of our processes.

Senator RIEGLE. The provision in the FTA which allows for suspension of duty reductions if imports from Canada are a substantial cause of serious injury—and that would allow a maximum of three years—how helpful would that provision be to the industry as you would see it?

Mr. COOPERMAN. Mr. Riegle, if it extended the 10 years to 13 years I think that would be helpful at the front end in the sense of instead of being out of business in four years, we would be out of business in seven years. So to that extent, it would be helpful.

Senator RIEGLE. Let me ask you one other thing. When you described the role that zinc alloy plays in our domestic economy, what are the most critical uses and applications that the country really ought to think about if we have got an industry that, in effect, may be shut down by this Agreement?

Mr. COOPERMAN. The automotive industry relies very heavily on zinc die castings for integral parts of their motor operations. By the same token, you cannot have tanks in our military programs, and you cannot have command and staff cars. You cannot have automotive equipment in the Army or in civilian life without zinc and without zinc die casting. That is probably the most critical use.

There are some alloyers who have been developing technology to provide materials for our aerospace and aircraft industry. There is one particularly on the West Coast. This represents investment of profits which, as I have indicated to you, will again begin to disappear. And that kind of advancement, that kind of high technology, will be lost to the American industry. We will not have zinc moving into the aerospace and aircraft industry as it has begun to.

Senator RIEGLE. The thing that disturbs me when I think about our longer-term economic future, with the trade deficit that we now have—about $170 billion last year—and the need to continue to maintain the high technology manufacturing capability in this country, in the automobile industry, in the aerospace industry, and so forth, if we don't retain these capacities internally to control the process, to be able to invest in research and development to upgrade our capability, if we continue to move all of these things off shore I really think that we reach a point where our own economic security is put into jeopardy.

It seems to me that the zinc alloy industry is one example that fits that concern.

Mr. COOPERMAN. We would agree with you, Senator. We are doing damage to our industrial base voluntarily. And while the FTA has a great role to play in our world, this kind of damage I think is beyond the pale of a Free Trade Agreement.

Senator RIEGLE. Well I appreciate your comments. Thank you, Mr. Chairman.

The CHAIRMAN. Thank you very much, Senator. Are there other Senators who would like to ask any further questions?

Senator BAUCUS. Mr. Chairman.

The CHAIRMAN. Senator Baucus.

Senator BAUCUS. If I could just briefly. The score here is 3 to 2; 3 against, 2 in favor, as I understand it. Let me ask each of the three who are now opposed: In your judgment, can implementing language be drafted in such a way to accommodate by and large your concerns? First, the clothing workers.

Mr. GUNDERSHEIM. I don't believe so, Senator. One is, the United States right now does not have any duty remission scheme nor any provision for such as far as I know. And several elements of the Agreement that strongly favor and give advantages to Canada I don't think can be rectified by implementing legislation.

Senator BAUCUS. All right.

Mr. Schwensen?

Mr. SCHWENSEN. We hope that it can, Senator Baucus. It will take cooperation from the administration I think to achieve that.

Senator BAUCUS. But at this point you are opposed to the Agreement?

Mr. SCHWENSEN. We don't want to state our position, but at this point we see no gains in it. And we could not encourage support of the Agreement, no.

Senator BAUCUS. So it is 2-2-1.

(Laughter)

Senator BAUCUS. Is it 3-2 or 2-2-1? See, we do not have a choice here, either yes or no, as it now stands, when implementing language comes up. And we hope that we will be able to encourage the administration to send up implementing language that will meet most of the legitimate concerns that various industries have.

Let me ask the question this way. If there is no implementing language at all addressing your concerns—zero, none—would you support or not support the Agreement as it now stands?

Mr. SCHWENSEN. We would oppose the Agreement.

Senator BAUCUS. You would oppose it. So you need implementing language to address some of your concerns.

Mr. SCHWENSEN. Yes, sir.

Senator BAUCUS. And do you think reasonably that that language can be drafted in a way to substantially address your concerns?

Mr. SCHWENSEN. We believe that it can. That is our endeavor anyway.

Senator BAUCUS. All right.

Mr. SCHWENSEN. And we do not believe that 100 percent of our concerns can be taken care of through that approach, but we think that some good progress can be made.

Senator BAUCUS. Mr. Cooperman?

Mr. COOPERMAN. We have tried, Senator Baucus. Because they have been so rigid about the tariff negotiations, we don't see very much hope for implementing language that would be useful to us.

Senator BAUCUS. So you do not think that the implementing language can address your industry's concerns?

Mr. COOPERMAN. If it is possible, we would be interested in it. But we have tried, counsel in our office have tried. We have been in communication with offices both on the Senate side and the House side, and we don't see it forthcoming, sir.

Senator BAUCUS. All right. Thank you. Thank you, Mr. Chairman.

The CHAIRMAN. Senator Baucus, as you watch these witnesses we have in the time that we have alloted, you are going to find that majority float back and forth. We are going to try to get all sides of this argument covered so the Senate and this Committee can be better informed as we decide what to do on this Agreement.

I defer to Senator Packwood.

Senator PACKWOOD. I thought, Mr. Chairman, this is an especially good panel this morning, and it exactly illustrates the problem we face about some good, some bad, within the scope of the Agreement. Mr. Gundersheim was honest. He doesn't think even within the scope of the Agreement we can fix it. And I think Mr. Schwensen thinks within the scope of the Agreement it could be fixed, but he is not optimistic that it will be. And these are the kinds of balances we are going to try to face. But it has been a very good cross section of a panel.

The CHAIRMAN. And as Senator Baucus says, unfortunately, we cannot say I am 65 percent for this and push that button. We either vote it up or down. Yes, Senator Matsunaga.

Senator MATSUNAGA. Mr. Chairman, the word we get is that the Canadians are very much opposed. They split about 50/50 as I understand it.

Now have you any word as to where your Canadian associates, those whom you associate with, stand on the FTA?

Mr. COOPER. Senator Matsunaga, I can say unequivocally our Canadian counterpart, regrettably, also members of our association, are strongly opposed to the Agreement.

Senator MATSUNAGA. I see.

Mr. COOPER. Our gains are their losses.

Senator MATSUNAGA. And to the extent that they may be able to defeat it in Canada, the Canadian Parliament?

Mr. COOPER. I think I would be fairly stating their objectives would be to defeat the Agreement.

Senator MATSUNAGA. Oh. Mr. Cooperman?

Mr. COOPERMAN. We have no counterpart, Senator Matsunaga, in Canada.

Senator MATSUNAGA. No counterpart. You have a counterpart sitting to your right there, Mr. Cooperman. Mr. Schwensen?

Mr. SCHWENSEN. As I understand it, the Canadian wheat producers support the Free Trade Agreement. Our losses are their gains.

Senator MATSUNAGA. I see. Mr. Turnipseed?

Mr. TURNIPSEED. The Canadian Chemical Producers Association do support the Agreement. And we have worked fairly closely with them on areas where we could come to some mutual common understanding.

Senator MATSUNAGA. I see.

Mr. GUNDERSHEIM. Senator, obviously our labor colleagues in Canada are very strongly opposed and probably more than ours. But what I think makes it more interesting is the industry position which, strangely enough, also seems to be opposed, the tough part is that they feel that it is a short trip.

The CHAIRMAN. Gentlemen, thank you very much. It has been most helpful to us. We will now stand in recess.

[Whereupon, at 11:28 a.m., the hearing was recessed, to reconvene on Wednesday, April 13, 1988 at 10 a.m.]

UNITED STATES-CANADA FREE TRADE AGREEMENT—1988

WEDNESDAY, APRIL 13, 1988

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The Committee met, pursuant to recess, at 10:01 a.m. in Room SD-215, Dirksen Senate Office Building Hon. Lloyd Bentsen (Chairman) presiding.

Present: Senators Bentsen, Moynihan, Baucus, Bradley, Mitchell, Riegle, Rockefeller, Daschle, Packwood, Roth, Danforth, Chafee, Heinz, Wallop, and Durenberger.

[The prepared statements of the Senators appear in the appendix.]

OPENING STATEMENT OF HON. DANIEL PATRICK MOYNIHAN, A U.S. SENATOR FROM NEW YORK

Senator MOYNIHAN. A very welcome good morning to our guests and our witnesses. I would ask that the hearing room come to order.

This is the third of a series of five hearings on the United States-Canada Free Trade Agreement, a measure which we look upon as historic in its implications for these two great neighbors. An example to the world is our relations as neighbors, and we hope shortly to be an example in our relations as trading partners and members of a vast single democratic free trade area.

We have two panels this morning and before they appear we will hear from our very good friend the distinguished Senator from New Mexico.

But first, the Senator from Oregon. Mr. Packwood, good morning, sir.

Senator PACKWOOD. Mr. Chairman, good morning. I made all the opening comments that I had to make yesterday. I can make them again, but they are the same comments.

Senator MOYNIHAN. We will include them in the record as if read. (Laughter)

Senator PACKWOOD. I am ready to hear the Senator.

Senator MOYNIHAN. Senator, good morning. We welcome you.

STATEMENT OF HON. PETE V. DOMENICI A U.S. SENATOR FROM NEW MEXICO

Senator DOMENICI. Good morning.

Mr. Chairman, Senator Packwood, I have some prepared remarks that I spent a bit of time on. They are far too lengthy for me to present here, and I wouldn't want to do that. Since I have the greatest confidence in this committee and its staff, I would ask that my general and specific observations with reference to this treaty be made a part of the record, Mr. Chairman.

Senator **Moynihan**. Without objection.

Senator **Domenici**. Mr. Chairman, I am going to speak a little bit about oil and gas. I don't want this committee to think that the Senator from New Mexico is unaware of the tremendous significance of this treaty.

Frankly, as the negotiations proceeded over the many months, I was privileged to at least be advised from time to time as to the progress, and I must admit that this is a rather historic set of understandings.

When you consider its ramifications for the United States, this hemisphere, and that this agreement might be the format for additional bilateral trade agreements, which might indeed be the new order of the day for the next three or four decades, I hope that it is understood that I consider this a significant achievement.

Second while the administration is very proud of that aspect which we might call the "energy security shield," it is an extremely significant event in America's growing energy dependence. If this agreement is implemented, in the event of a crisis, which would cause a shortfall of significant proportions, the shield aspects would come into play. The Canadians would have to continue to sell in the same proportions, with no price disparity between what they sell to Canadians and Americans. I think that is very significant, and if it were the only part of this agreement, it would be a worthwhile agreement.

On the other hand, I do believe that it is fair to say, when it came to the energy and oil and gas section of this negotiation, that the Canadians got the best of us. I don't care to categorize what they themselves have said about whether they got the best of us or not, other than to say that their head negotiator has been heard to say that, with reference to this particular part of the agreement, they did indeed get the best of us.

Now, that may be their impression, and there may be some in the United States that think we got the best of the energy negotiations in this agreement.

I want to talk about just two things:

First, this agreement has a series of whereas's, which I might say to the Chairman and to you, Senator Packwood, are magnificent whereas's in the energy section, which, when you finish reading all of the language—it is supposed to result in, a level playing field. As my good friend from Arizona, the distinguished Congressman Udall, quoted his law professor cautioning: "Be sure that the whereas's match up with the therefore be it resolveds." The problem, as I see it, is that the whereas's are all very neat and nice and all move towards what is called a level playing field: But then when you look to the therefore be it resolveds, I would strongly urge that the Committee look very carefully to see if the resolved clause which says we are going to have a level playing field, really is the case.

Frankly, I don't believe it is the case. It is amazing that we are here, with a very dedicated and I think a very farsighted Committee, still not having before it a detailed analysis by anyone from either country that has authentically evaluated the incentives on both sides of the border, and that would in fact determine whether or not we are moving toward or indeed have a level playing field. There is no such evaluation of Canadian incentives for the production of oil and gas vis-a-vis the American producer.

I understand the Department of Energy is in the process of completing one. I understand that the distinguished Chairman of the full committee might even have been briefed orally by the Department of Energy on what that report might look like, though they are not through yet.

They have some very ingenious incentives, in particular for those who are independents producers. And I remind the Committee that a substantial portion of America's finds and America's drilling activity is done, has been done, and I assume will always be done by the independent producers.

Today I just want to say that I have introduced a bill to call to your attention the disparities. It has a very long title, but I hope as you move through consideration of this—it will have many more cosponsors. In a nutshell it is: Use the Canadian Free Trade Agreement to level the playing field, and it proceeds to itemize the kinds of incentives that we might consider in order to make the playing field level, one of which was to get rid of and repeal the Windfall Profits Tax. I note that that might occur by virtue of the Omnibus Trade Act, but it was one of those disparities. If they don't have one, we shouldn't have one for starters.

Now I would like to suggest that you take a very good look at the total evaluation of the incentives and remember one thing: Even the Department of Energy has ignored—and I say this particularly to my good friend Senator Packwood—the significance of the alternative minimum tax, which is part of Tax Reform, and a very significant part. That has been ignored in the evaluation as it might apply to the independent oil and gas producers in this country.

I am not recommending anything to you other than, if you ignore it, you do put a completely different context and flavor on the level playing field as it pertains to the independent producers.

The Canadians have promised a number of times to give us all of their incentives, those that are national and those that are provincial. Maybe you all have seen such a document that says it is the entire list; I have not. I don't think we have any. I think you should insist on that from someone in an official manner before you proceed with reference to this section.

I believe we are going to go down in production, they are going to go up, especially on the independent production side and I believe it is grossly unfair to do that when we have a very depressed oil and gas industry, especially the independents of the United States.

Second, there is another aspect of oil and gas law that has to do with rules and regulations; principally the way the Federal Energy Regulatory Commission conducts business, in its regulatory capacity. I just want to give you one example, then I am open for questions; but most importantly, I can get out of the way so you can hear from the rest of these witnesses.

Under FERC there is a very important provision called the "as-billed" provision or regulation. That was done at my request; at least I called it to FERC's attention. What it clearly tried to do was to inhibit the Canadians from leaving out of the billing price of natural gas that was coming from Canada to the United States some of the costs that go into the process, so that they could produce for the various regulatory commissions in the United States a lower cost of natural gas than the real cost. And thus it became known a "the as-billed regulatory process."

We have it, in effect. And on this one, I must say, we called it to the administration's attention when the negotiations occurred. We received communications from them saying that indeed they did not give up on the "as-billed regulatory scheme" to inhibit an unfair billing price of natural gas by the Canadians.

Our administration, in responding to us, says that they kept it. I would call your attention to the Canadians' analysis of the Free Trade Agreement. It is called "Trade Securing Canada's Future—The Canada-United States Free Trade Agreement." It is dated October 12, 1987. And I would just read from page 142, just one sentence, because it seems to me that we have one version of FERC 256. The administration says they preserved it in this negotiation, so we would have the equity of billing and not use billing gimickry to get into the regulatory commissions with a lower price than we have, and they win if they come in lower. I read as follows:

"If discrimination inconsistent with this agreement results from a regulatory decision, direct consultation can be held with a view to ending any discriminatory action, such as the decisions earlier this year by the Federal Regulatory Commission prohibiting Canadian suppliers of natural gas from passing all of their shipment costs on to their customers. " I believe that is exactly inconsistent with FERC Rule 256, which is tremendously important to the natural gas suppliers, in particular in my State, the State of Texas, and others.

I think they are saying here that they have a different understanding than the administration, with reference to the "as-billed," which we thought would remain as we were interpreting it. I think they are saying it is negotiable.

I urge that, as you look at this and its final implementation language, that you attempt to clarify situations such as this.

And in closing, I call to your attention that for those who say this is a very historic agreement, I agree. For those who say it might indeed be a model for this hemisphere and for the future, I agree. However, I therefore draw a slightly different conclusion. Since it is all those things, we ought to make it the very best we can get. We ought to make sure that in areas as important as the continued development of oil and gas in a rational and reasonable manner in the United States, that we have not set some precedents in this historic agreement that we will be sorry about and that will set the model for comparable agreements in the future.

I ask that my entire testimony be made a part of the record. And again, thank you very much for permitting me to share a few thoughts with you regarding oil and gas, and again call to your attention that the level playing field implementation language might very well be of some interest to this Committee in terms of the incentives we might consider to make the field more level.

Thank you very much, Mr. Chairman, and members of the Committee.

[Senator Domenici's prepared statement appear in the appendix.)

Senator MOYNIHAN. We thank you, Senator Domenici. You know the great regard with which you are held by this Committee and any legislation introduced by you, in association with Mr. Boren, Mr. Nichols, Mr. Johnston, Mr. Wallop, Mr. Breaux, Mr. Simpson, Mr. Bingaman, and Mr. McClure, that tells us that this is a matter in which we ought to be engaged, and we will be.

I would like to give our Committee members an opportunity to comment on your remarks, in the order that they have appeared.

Senator Packwood?

Senator DOMENICI. I just want to say to Senator Packwood, if you favor cold slurry, you ought to let me go, because I may be the critical vote on whether we get cold slurry out of the Energy Committee. (Laughter)

But other than that, I would be delighted.

Senator PACKWOOD. Well, I may have a couple of hours of questions.

Senator DOMENICI. I will send my proxy, in that event.

Senator PACKWOOD. I did want to ask you one generic question, when you talk about a level playing field, windfall profits and then in your statement you have got Royalty Holidays in Canada—we don't have them here. You have got expenses versus deduction of geological expenses.

On a level playing field, let us take the Windfall Profits Tax. Are you saying that in order to have a level playing field, if we pass a Windfall Profits Tax, Canada has to pass one? Are they to sort of come along and do what we do in order to keep the field level?

Senator DOMENICI. Oh, no.

What I am saying, Mr. Chairman, is that the intention of this agreement as expressed in the whereas clauses is that we are going to have a level playing field. And for starters I am saying that, if I were in your shoes, I would read that.

Then I would ask: "Well, we have had great negotiators; but do we have anything close to a level playing field?" They have said that. And I am trying to suggest that, with the derth of information and a few comments that we have heard from them about this section, the oil and gas section, that they are very excited about it. They seem to think they got a very good deal. I would like some objective evaluation as to how close to level the field is.

We have the prerogative, if it is not level, if there is substantial incentives going in that favor them, we have the prerogative of using the Canadian Free Trade Agreement enabling legislation to attempt to make it level.

Senator PACKWOOD. I just want to make sure that I understand. Did you not say, no, that it needs to be made level necessarily at their expense if the reason it is unlevel is because of laws we choose to put on the books, affecting our own industry?

Senator DOMENICI. No. I am suggesting, however, that if they don't have a Windfall Profits Tax, and we think we are trying to get a level playing field, we and you as a Committee have a responsibility to look at Windfall Profits Tax and say, "Should we have it?" since it is significant and could be in the course of the next 10 years or so, could have a significant unleveling affect. And I believe that for Canadian free trade reasons or otherwise, is being found to be a very negative law by the U.S. Congress, and we will probably do away with it.

But there may be others that we ought to look at now and fix. And frankly, if we don't, there may be some who will not support the Free Trade Agreement because, indeed, the playing field is not level, and we are not ready to make it level.

Senator **Packwood**. A last question then, Pete. I don't know the specifics of the Canadian taxation of the Canadian energy industry, so my question may be wrong; but generally, since we passed tax reform, our corporate and individual rates are lower than Canada—generally. If that also would be true for the energy industry, would that argue that we would have to raise our rate in order to make the field level?

Senator **Domenici**. No, it doesn't, Senator Packwood. And I would urge that even with the information that I have been able to obtain, I don't think you ought to be terribly worried about us having any significant advantage because of your marvelous Tax Reform Bill.

I think any analysis of the entire picture of Royalty Holidays, bonuses that were given to independents to go out to drill—we don't know the status of all of those. Some are provincial, some are national. I don't think anybody would come here and say we've got the better of the deal. I think most people are going to be here speculating that we probably have a worse deal for ours, and I am just suggesting that you ought to know how much worse it is and then try to do something about making it level, unless you want to conclude that the disparity in production should continue on indefinitely in favor of the Canadians because, after all, we have got a nice shield.

But don't forget, to the extent that we become dependent, when we have supplies, we will run around moaning about the trade imbalance, and it may soon be 40-50 percent from energy—that trade imbalance that we are talking about.

Senator **Packwood**. Thank you, Mr. Chairman.

Senator **Moynihan**. Do I take it, Senator Domenici, that you are settled in your view that we should not raise taxes on the oil and gas industry?

Senator **Domenici**. I am. (Laughter)

I am absolutely settled on that view. As a matter of fact, I believe we ought to look at doing some things to relieve some of them, in particular the independents.

Senator **Moynihan**. We thank you, sir.

Now, before you leave, is there any other member that wishes to comment?

Senator **Baucus**. One quick question, if I might, Mr. Chairman.

Senator **Moynihan**. Yes, of course.

Senator **Baucus**. I apologize that I was late.

As I understand it, Senator, you testified on oil and gas primarily and to the energy industry generally. What effect does this agreement have on the uranium industry?

Senator **Domenici**. We have had that debate on the floor, and thanks to you I might say, and many others, we attempted to provide a 12-year moratorium on the implementation of a provision in this agreement, at least as I read it, that vitiates the 1965 Protective Law with reference to American uranium. But if this agreement is passed without any implementation language with reference to uranium, then it is my assessment today that we have wiped out the national law here which provides and mandates a viable uranium industry.

Senator **Wallop**. Mr. Chairman, could I just have a moment?

Senator **Moynihan**. Of course. Senator Wallop.

Senator **Wallop**. Is it your view that in some way or another the passage of this treaty would cement the relative tax positions of the two countries?

Senator **Domenici**. No, it is not.

Senator **Wallop**. So what you are essentially saying—I don't want to put words in your mouth—is that the passage of the Free Trade Agreement is not dependent upon the passage of these other tax alleviations and tax treatment that would be recommended?

Because as I read it, essentially for the oil and gas industry there is no inhibition to import from Canada at this moment.

Senator **Domenici**. That is correct.

Senator **Wallop**. So, our problem is really sort of outside the Free Trade Agreement; it is nurturing and caring for a domestic energy industry, which we ought to be doing as a matter of policy, anyway, and would be permitted to do with or without this agreement. Is that right?

Senator **Domenici**. I think that is essentially correct; however, it seems to me that in the course of events, for a country like ours and a country like Canada, you can walk along from year to year with a significant tax incentive disparity between the two nations and a rather free-flow of the product.

But when you come along with an agreement as significant as this, which clearly is calculated to put the two countries very close together in terms of protecting each other on energy it seems to me that in the course of events that provides a rare opportunity to say, "If we are going to do that, why should we not take advantage of the situation to create as level of an incentive field as possible?" It is not going to have every "i" dotted and every "t" crossed, because we have different systems. But clearly they are very gifted in Canada, in my opinion, in terms of figuring out indirect kinds of subsidies and incentives. And then, they have a Federal and a Providencial level of incentives and subsidized arrangements.

I frankly cannot conclude, from everything I have seen today, that the whereas's about the level playing field are the reality. If we don't do something to change, we will be in a field that will not be level.

Senator **Wallop**. We will, but not particularly because of the Free Trade Agreement, but because of a field that is not level today as we enter into it. But we would be permitted—would we not?—to address those things in the course of time.

I am a cosponsor with you of this bill, and I would like to see it done in advance. But my view of things, given the budget, given the election year, given a number of things, is that we will be more than a day or two getting to all of the things that are contained in our bill.

But I think we would be within our rights as a nation to pass those subsequent to, or with or without the Free Trade Agreement. We ought to, I think.

Senator DOMENICI. Let me say to my friend from Wyoming, I have done my best, along with a few other assignments that I have, to stick my nose in your business. But I am no expert you all are the experts on this agreement.

But I think there are some privileges that are going to flow to the Nation of Canada as a result of this Trade Agreement that they do not now have in many areas and, conversely, to us. And there are some in the oil and gas and energy field that they do not now have that we are going to give, aside and apart from the shield that we agree on as a contingent event that might occur and might not occur.

So I don't want to give you an absolute answer that nothing is changing; I think some things are.

Let me just repeat FERC Rule 256 may indeed have been changed. We think it wasn't; they think maybe it has. That is very significant.

Senator WALLOP. That I agree with.

Senator DOMENICI. And there may be others.

Senator WALLOP. That I agree with, but that is something I think we could do, make that understanding.

Senator DOMENICI. Thank you very much, Mr. Chairman.

Senator MOYNIHAN. We thank you, Senator.

Senator Wallop, did you wish to make an opening statement?

Senator WALLOP. Mr. Chairman, no. I have made more than enough comments on this already.

Senator MOYNIHAN. Senator Rockefeller, would you wish to make an opening statement?

Senator ROCKEFELLER. Yes, Mr. Chairman, and I thank you for that.

Senator MOYNIHAN. You are very welcome, sir.

OPENING STATEMENT OF HON. JOHN D. ROCKEFELLER IV, A U.S. SENATOR FROM WEST VIRGINIA

Senator ROCKEFELLER. Coal and gas are fundamental to the economy of my State of West Virginia, and, Mr. Chairman, my decision with respect to the Free Trade Agreement is going to be influenced very strongly by the effect of the Free Trade Agreement on gas and coal.

Secretary Baker and USTR Ambassador Yeutter testified before this Committee not long ago, and I raised a number of questions with them at that time about the effect of the Agreement on coal and gas. I followed that up by submitting a number of questions to the administration. I have not yet received an answer.

To be frank, I am concerned about subsidies to the Canadian electric utilities that let them produce electricity at costs that are lower than we face here with American utilities. I am worried that Canadian utilities, which have the status of Crown Corporations may have an unfair advantage because of that particular relationship to their government.

I a troubled that a less rigorous system of environmental regulations in Canada works to the detriment of some of our utilities, and I am also bothered that Canadian oil companies may be receiving tax advantages that make it more difficult for our coal companies to compete.

Finally, the regulatory system for gas in this country treats imported Canadian gas better than domestically produced gas. That is a situation which I do not think ought to be allowed to stand.

Mr. Chairman, I am of an open mind, but I must say that my feelings are rather strong with respect to the coal industry and the gas industry. I am watching closely how the Free Trade Agreement will affect those industries in my State of West Virginia.

Senator MOYNIHAN. Sir, may I ask, would it be your wish that the Committee staff prepare a special report on the energy sector and with respect to those specific issues that you have raised so very vigorously, when Ambassador Yeutter was before us in the first of these hearings?

Senator ROCKEFELLER. That would be very helpful, Mr. Chairman.

Senator MOYNIHAN. Well, you speak with great authority in matters of coal and gas; I mean, you are the exemplar on our Committee. And if that is your wish, we shall see that it is done and we appreciate very much your concern. We would like you to take over the task of seeing that it is done right.

Senator ROCKEFELLER. Thank you, Mr. Chairman.

Senator MOYNIHAN. We appreciate that.

With respect to opening statements, Senator Durenberger.

OPENING STATEMENT OF HON. DAVID DURENBERGER, A U.S. SENATOR FROM MINNESOTA

Senator DURENBERGER. Mr. Chairman, on the issue of energy, I would suggest that the interdependence of our two countries ought to be quite obvious to us.

I come from a State that is very, very dependent on our neighbor to the north for the degree with which my State can be energy independent. And, when national energy policies in the United States, as in the early '70s and the late '70s, got the whole country in trouble, the whole country did not suffer as much as those of us from northern agricultural States did from failures of that energy policy.

Obviously at that time the Canadians took some advantage of us and in part that advantage has been addressed—not to everyone's satisfaction, but it has been addressed—during the course of these negotiations.

I just hope that my colleagues who are trying to preserve a constituent interest in domestic production remember this is one country, one continent, and that part of what we are doing here in this Free Trade Agreement is trying to demonstrate to the world that these two nations can move in the direction of a fair Free Trade Agreement. In some very substantial areas, we are interdependent nations.

I just hope we all keep that in mind as we walk through these various sectors of the agreement.

Senator **Moynihan**. I would like to associate myself with that sentiment.

Senator Chafee?

Senator **Chafee**. Mr. Chairman, I don't have a statement. I just want to say that I am delighted we are into these hearings. I consider this Agreement one of the most exciting undertakings that has come through the Congress, since I have been here, anyway. I think it bodes well for the world if the United States and Canada can ratify this Agreement.

I am supportive of it. Obviously, I want to hear the testimony of the witnesses that come along; but I want to commend everybody that had a hand in this, particularly the administration, Prime Minister Mulroney, and others. I think it sets a tremendous standard for the world that we, these two nations with the largest trade flow in the world, are embarking on this. I think it speaks well for our administration, for this Nation, and for Canada.

Senator **Moynihan**. I could not more agree

Senator Baucus?

Senator **Baucus**. No opening statement, thank you.

Senator **Moynihan**. Senator Daschle?

Senator **Daschle**. Senator, I have no statement to make.

Senator **Moynihan**. Thank you, gentlemen.

At the request of Senator Bentsen, we are going to reverse the order of our panels this morning

So we will first hear from the second panel. That will be Mr. Robert Hiney, the Executive Vice President of the New York Power Authority, and Mr. Thomas Altmeyer, who is Senior Vice President of the National Coal Association.

As is our practice, we will proceed in the order that the witnesses are listed.

Mr. Hiney, good morning, and we welcome you.

STATEMENT OF ROBERT A. HINEY, EXECUTIVE VICE PRESIDENT OF MARKETING AND DEVELOPMENT, NEW YORK POWER AUTHORITY, NEW YORK, NY

Mr. **Hiney**. Good morning. Thank you, Mr. Chairman.

Mr. Chairman and members of the Committee, my name is Robert Hiney. I am Executive Vice President for Marketing and Development for the New York Power Authority. My responsibilities include planning for future electricity supplies, negotiating contracts with other utilities both domestic and Canadian. That is part of my job.

I appreciate this opportunity to discuss a matter the Power Authority considers most important to electricity consumers in New York State and in the rest of the country.

Our Power Authority is the largest nonfederal public power agency in the United States. We provide about a third of New York's electricity. Our customers include basic industries, government agencies, including New York City and its mass transit system, publicly-owned and investor-owned utilities which deliver our power and its savings to consumers throughout the State.

We also provide low-cost hydropower to seven neighboring States under Federal requirements.

Our mandate is to provide the cheapest power possible. This is both a statutory and a practical mandate. We have no franchise area. The Power Authority is a fully competitive utility. We must market our electricity at competitive prices.

The Power Authority operates two large hydroelectric projects, two nuclear plants, a pumped-storage hydro plant, a gas-and-oil fired plant, and several small hydro facilities.

In addition, we operate approximately 1,400 miles, circuit miles, of transmission. In 1987 we produced nearly 36 billion kilowatt hours of electricity. We purchased and distributed another 8.4 billion kilowatt hours from Canadian sources.

We have a longstanding relationship with Canadian utilities. At both our major hydroprojects on the Niagara and St. Lawrence Rivers we share water resources and coordinate operations to ensure optimum use of the available water.

We have purchased surplus energy from Ontario Hydro since the mid-sixties. In 1978 we began buying 800 megawatts of firm power from Hydro-Quebec. This power is available from April through October, a period of peak need in New York but of lesser use in Canada.

We also began buying larger quantities of surplus nonfirm energy from Quebec on an as-available basis, and we buy this only when it is cheaper than the energy from New York State sources.

In January of this year we signed a Memorandum of Understanding with Hydro-Quebec for the purchase of 1,000 megawatts of firm year-round power, power that can be counted on for capacity needs.

Since 1978, New York consumers have saved more than $600 million as a result of the Hydro-Quebec purchases. But these purchases are still only a small fraction of New York's electric needs.

Last year only 11 percent of our electric energy came from Canada, and most of this was non-firm surplus power. This surplus allowed us to save money in New York by reducing the operation of our more expensive plants.

Well, how does this relate to the potential effect of the Free Trade Agreement on consumers and industries in the U.S.?

At the Power Authority we feel any effect of the agreement will be positive, and we support its implementation.

As we understand it, the Free Trade Agreement does not materially change the status quo regarding electricity trade. Historically, electricity has flowed across the border, bound by economic considerations and not by artificial barriers Since this trade has operated on a market-driven basis, the Free Trade Agreement provides additional safeguards in the area of price, regulatory actions, taxes, and other potentially discriminatory treatment.

The large-scale hydropower resources now being developed in Canada enjoy a significant cost advantage over other large-scale generating options. That fact is clear. This advantage is the essence of the cost disparity between power generated by U.S. domestic utilities and that which is generated in Canada—and this is true with or without the Free Trade Agreement. We are dealing with very large hydroelectric resources which are inherently economic. Hydro-Quebec in Canada has them, and we don't in New York.

It makes good sense from an environmental standpoint to maximize our use of economical hydro resources wherever they are located before turning to fossil fuels. This helps conserve the world's non-renewable energy reserves.

In the Northeast the Canadian hydropower will principally displace imported oil and natural gas-fired generation

And in New York State about half of the generating capacity is oil-dependent.

So even with a helpful assist from Canadian energy, last year we had to rely on oil and natural gas for 38 percent of our State's electricity production.

We believe imported Canadian power especially under the terms of this agreement, is a positive development for American industry and for American consumers, not just in New York and in the Northeast but also in markets across the country that are accessible to Canadian exports.

We all agree on the importance of enhancing the competitiveness of American industry. The price of energy in general is of key importance in the competitive pricing of U.S. products, and the cost of electricity is especially crucial since it is increasingly becoming the energy source of choice in powering our industrial and commercial sectors.

Avoiding barriers to free United States-Canada trade in electricity will have positive effects in enhancing the United States' competitiveness by helping control electricity prices, lessening oil dependence, and strengthening friendly relations between two neighbors.

[The prepared statement of Mr. Hiney appears in the appendix.]

Senator **MOYNIHAN**. We thank you, Mr. Hiney. Mr. Altmeyer.

STATEMENT OF THOMAS ALTMEYER, SENIOR VICE PRESIDENT, GOVERNMENTAL AFFAIRS, NATIONAL COAL ASSOCIATION, WASHINGTON, DC

Mr. **ALTMEYER**. Mr. Chairman, the National Coal Association supports the concepts of free trade embodied in the Free Trade Agreement. National Coal is concerned, however, that adverse consequences to the U.S. coal industry may result from an increase in electricity imports and from a dimunition of our ability to compete with Canadian coal producers. Both could result in lower coal production in the United States than would otherwise be expected.

A further significant question exists on the authority and the ability of the Canadian Federal Government to fulfill its commitments where conflicts exist with the provinces.

NCA recommends that the Committee evaluate the concerns raised by these issues in formulation of implementing or companion legislation.

The U.S. coal industry is in a unique position with respect to trade with Canada. Canada is the single largest foreign customer for our coal, importing an average of 15 to 16 million ton annually. However, the potential exists that the coal industry could lose domestic markets as a result of an increase of electricity imports.

Since 1970, the United States has experienced a six-fold increase in electricity imports. In 1987, approximately 47 billion kilowatt hours were imported. Electricity imports are projected to continue to increase to a net peak of approximately 63 billion kilowatt hours by 1995.

This increase is occurring for two reasons:

In Canada, utilities have cost advantages available by virtue of their status as Crown Corporations, and because of the type of generating capacity available. They are being actively encouraged to increase exports by their government.

Canada recognizes the opportunity to their utilities and their economy from the export of power. The excerpts on pages 6 and 7 of my statement quoting Marcus Massey, Energy, Mines and Resources Minister in Canada, in remarks to the Board of the Canadian Electrical Association this past Fall clearly reflect the Canadian focus on power exports as a major economic stimuli with the potential to reap enormous rewards for Canada and its industries.

The second reason imports are increasing is U.S. public policy and regulatory practices which discourage domestic utilities from building facilities necessary to meet their own electricity requirements.

The Free Trade Agreement did not address the identification and elimination of subsidies affecting free and fair trade however, Article 1907 would establish a working group to seek to develop more effective rules and disciplines concerning the use of government subsidies and to seek to develop a subsidy system of rules for dealing with unfair pricing and government subsidization.

Language directing the working group within a time certain to assess, identify and quantify subsidies available to either United States or Canadian utilities and to recommend ways to offset advantages that these subsidies might afford in electricity trade should be included in the implementing legislation.

On the domestic side, Congress must look at U.S. laws and regulations that put the U.S. electric utility industry at a competitive disadvantage with Canada.

With respect to coal production, structural and policy differences between differences between our two countries result in the United States and Canadian coal industries competing on unequal terms. Canadian mining companies are permitted to deduct all exploration and development expenses and a depletion allowance of 25 percent. A variable investment tax credit is also provided. Canada does not have a black lung tax or Abandoned Mine Lands fee, which collectively total $1.25 a ton for underground coal and 90 cents per ton for surface coal in the United States.

Tax costs in Canada represent between 1 and 16 percent of mining costs. In the United States, tax costs between 17 and 25 percent of mining costs. To make the economic unit envisioned in the Free Trade Agreement equitable for all concerned, we would suggest changes to afford U.S. producers more favorable tax treatment, similar to that available to the Canadian coal industry; a more level playing field to be effected initially through restoring the percentage depletion allowance to the pre-1983 effective rate of 10 percent; removing half of the depletion allowance as a preference item for the Alternative Minimum Tax, similar to book income; allowing full expenses rather than partial capitalization of exploration and development costs; and crediting coal companies' Abandoned Mine Land payments toward their Superfund excise tax liability.

A final area of generic concern to the underlying rationale for the Free Trade Agreement with respect to energy, as well as all trade, is the ability of the Canadian Federal Government to enforce the provisions of the Free Trade Agreement.

The Canadian Federal Government does not have the same level of authority over provincial governments as the United States over the States. In discussing the Free Trade Agreement, the Ontario Attorney General, Ian Scott, cited a Privy Council decision reviewing the landmark Canadian Supreme Court case in the Labor Conventions case. He stated, referencing that decision, that:

"The Federal Government in Canada has the power to make a treaty. The Federal Government of Canada does not have the power to implement that treaty in areas of provincial jurisdiction."

It can be inferred from this decision that in area where provincial jurisdiction overrides, the Canadian provinces will not have to abide by the terms and conditions of the Free Trade Agreement. It would appear that each province may have to ratify the Free Trade Agreement for it to be effective.

This vitally affects electricity and other energy trade. Provincial governments exercise control over the electric utility industry in several areas, as well as all natural resources.

We would just submit that this is a very serious question. We would encourage the Committee to seek clarification of it.

To the extent that the United States feels it is obtaining access to Canadian natural resources under the Free Trade Agreement, only to find out when a shortage arises that the provinces are not bound, would be a sorry situation down the road.

Thank you, Mr. Chairman.

[The prepared statement of Mr. Altmeyer appears in the appendix.]

Senator MOYNIHAN. Thank you, Mr. Altmeyer.

I have two questions, but I would just like to draw the attention of the Committee to an elemental proposition.

Mr. Altmeyer testified that in 1987 Canada was our largest customer for coal, importing twice as much as the next two leading countries Japan and Italy—an important fact.

And you testified that most of this coal comes from Appalachia and makes its way up, for example, to Ontario Hyrdo.

I would like to point out to the members of the Committee that the United States exports twice as much to the Province of Ontario as we do to Japan. Twice as much. Ontario is the biggest customer for us, by a factor of two over Japan.

Thus, you have to bear with me from time to time on highway bills, when I fight off Buy-America on cement. Appalachian coal goes North to produce Canadian cement, some of which comes back, and that is fine. That is what trade is all about.

But just note that. And thank you for that testimony.

Mr. Hiney, if I could just ask you: I understand that perhaps the Committee would want to know about the nature of the hydroelectric electricity coming down from Canada.

First of all, these rivers flow North into the Arctic, and so hydroelectric installations have much less impact than they would otherwise, and it is the nature of the area that Quebec, to install efficient hydro-dams in that part of the world, they couldn't consume it all in Quebec; it needs to come down to these United States, some of it reaching Southern California, Senator Packwood mentioned to me.

There is no tariff on this electricity, and the first agreement we made in the Trade bill conference is that there will be no tariff.

You have just had a new agreement with the Canadians on electrical power, have you not, Mr. Hiney? Could you tell us about it?

Mr. **Hiney**. Yes, sir. It is a Memorandum of Agreement which outlines the basic commercial terms for the purchase of 1,000 megawatts of firm capacity and energy from Hyrdo-Quebec, beginning in 1995 with 500 megawatts and then a year later another 500 megawatts. Each block will run for 20 years.

This will be the first purchase by the Power Authority of year-round firm capacity. It can be used to be part of the utilities-generating mix. In other words, you can count on it to meet its capacity needs in lieu of purchases from others or investment in plant, and we would be marketing that electricity to utilities serving the southeastern part of New York State, where most of our high-cost oil fire generation is based.

This will be a substantial benefit to particularly that region of New York State.

Senator **Moynihan**. To wit, Long Island.

Mr. **Hiney**. Yes, sir, Long Island, New York City, Rockland County.

Senator **Moynihan**. And our oil-generated electricity, that is imported oil.

Mr. **Hiney**. Yes, sir. We certainly import it to New York, and a good deal of it comes from the Mid-East. Really, our geography is one of our principal assets in the energy field. We share a border with Quebec, who has been endowed with some enormous natural resources in the northern part of the province, and we wish to use that as part, a balanced part, of an overall mix of resources that will enable us to control our dependence on imported oil and keep it to a minimum.

Senator **Moynihan**. Well, I just want to say I like the picture. I like the picture of Appalachian coal going to Ontario and Quebec hydroelectric power coming down to New York, and just taking these two democratic countries and putting their economies even closer together. It just makes sense to me.

Senator Packwood?

Senator **Packwood**. No questions.

Senator **Moynihan**. Senator Rockefeller?

Senator **Rockefeller**. Thank you, Mr. Chairman.

Mr. Altmeyer, on page 6 of your testimony, you referred to the fact that a number of U.S. utilities choose to import power rather than build utilities in this country, simply because of the risk, the time required, and bureaucratic regulations. In fact, has this grow worse in recent years?

Mr. **Altmeyer**. Yes, Senator, it has. I believe that there are currently approximately six new coal-fired generating facilities planned within the next 10 years within the United States. There are no plans beyond that in the future.

Most utility systems appear to be very risk-adverse; they don't want to take the chance of constructing a new facility only to be subsequently told by a public utility commission that that was not a prudent decision when they made it, and to be told that they are unable to pass the cost of that new construction along into the rate base.

There is clearly capital aversion at least from our observation in the utility industry.

Senator **Rockefeller**. There have been no plans for 10 years?

Mr. **Altmeyer**. Excuse me, Senator, that I do not believe there are any plans going forward at this time to construct any new coal-fired generation capacity that would be coming on after approximately the year 1996. There are plans for additional coal-fired generating capacity between now and 1996.

Senator **Rockefeller**. OK.

Is it your impression that the Canadian coal industry has suffered coal job losses commensurate with our own, in Appalachia, for example?

Mr. **Altmeyer**. I am not in a position to reflect on specific statistics, Senator. My impression would be that they have not suffered coal job loss similar to what we have suffered in Appalachia.

The primary coal development regions in Canada are in the northeastern provinces which basically supply coal to coal-fired generation capacities—coal-fired power plants in New Brunswick and Nova Scotia. And in the western provinces of British Columbia and Alberta, the bulk of that coal goes to the export market, primarily to Japan.

Senator **Rockefeller**. In 1977, there were 66 000 coal miners working in West Virginia. Today there are about 20,000 working. Now, some might point out that those 20,000 are producing more tonnage than the 66,000 did in 1977; but, nevertheless, the job loss is pretty devastating for my State.

Is it your view that tax changes would have to be made in the United States in order to equalize the competitive situation with coal and move you more towards supporting the Canadian Free Trade Agreement? If so, what kind of tax changes are needed?

Mr. **Altmeyer**. Yes, Senator. My view would be that the tax changes would have to occur here within the United States. You know, it is not appropriate for the Free Trade Agreement to attempt to direct Canada or their tax policy on natural resource development. However, we must recognize that we are placing the U.S. coal industry at a disadvantage.

A recent—not publicly released yet—analysis by the Bureau of Mines, as I indicated in my statement, not in my printed statement but in my oral statement, indicates that the cost of taxes per unit of production in Canada in the mining industry ranged between 1 and 17 percent. In the United States the rang is between 17 and 25 percent.

Currently we are competing with Canada in international markets. Fortunately probably, from our standpoint, we are not competing with Canadian markets and U.S. markets except of a slight degree in the industrial market in the Pacific Northwest.

The specific tax changes that we would recommend be considered at this time would be the restoration of the full 10-percent statutory depletion rate for the coal industry—it has been reduced in increments over the last four years to an effective rate of 8 percent—the elimination of one-half of the percentage depletion allowance for inclusion in the Alternative Minimum Tax, similar to what is done with book income.

The coal industry, as any capital-intensive industry, is disadvantaged by the Alternative Minimum Tax. It fundamentally negates the reason that the preference items were put in the Internal Revenue Code to begin with.

The other area is: Currently the U.S. coal industry must capitalize 30 percent of exploration and development costs. In Canada they can expense 100 percent. We would recommend going back to the former law in the United States of expending 100 percent of exploration and development cost.

Those are the major issues that we focus on primarily because those are the major issues that have been focused on by this Committee and the Congress over the past several years.

Senator ROCKEFELLER. Do you have any estimate of the number of tons of coal sales from Central Appalachia that have been lost due to Canadian power imports over the last several years? I have heard figures ranging up to 20 or 30 million tons, with perhaps, as much as 60 million tons by the 1990s.

Mr. ALTMEYER. Senator, if you did a straight analysis of how much power is coming in from Canada to the United States and how much coal would have to be produced to generate that power, a figure of 60 million tons could be accurate

If you look at the more pragmatic assessment and an analytical assessment of how much coal has been displaced, our analysis indicates that from 1981 to 1985 there was displaced approximately 5 million tons of U.S. coal. Some of that coal displaced has come from North Dakota; the bulk of it from Appalachia, however.

Our projection, a preliminary projection, is that by 1996, at current trends, we will displace approximately 24 million tons of our U.S. coal production. I cannot say specifically how much of that is coming from Appalachia.

We should also note, while we do export a significant amount of coal to Ontario Hydro, who is one of our best customers, the amount of power exported from Canadian provinces to the United States as opposed to the amount of coal that we are exporting to them for the generation of power, for the first time in 1986 the amount of imported power exceeded the amount of displaced coal. What I am trying to say is it was a net loser for the United States for the first time. There was more coal-equivalent power exported to the United States than there was coal exported to Canada for the Northeastern Region of the United States.

Senator ROCKEFELLER. Thank you Mr. Altmeyer. Thank you, Mr. Chairman.

Senator MOYNIHAN. Thank you, Senator Rockefeller. Senator Chafee.

OPENING STATEMENT OF HON. JOHN H. CHAFEE, A U.S. SENATOR FROM RHODE ISLAND

Senator **Chafee**. Mr. Chairman, it seems to me that as we go through these hearings, we have got to determine what is a subsidy and thus distorts the so-called level playing field and what isn't. And this goes back to a question that Senator Packwood asked earlier: If we tax and the Canadians don't, is that unfair? If we require capitalization and the Canadians permit expenses, is that a subsidy? Is that tilting the playing field against us?

The Black Lung Tax is a tax the United States chose to impose when the Black Lung Program was passed or changed dramatically back in about 1979, or thereabouts, and we paid for it by increasing the Black Lung Tax. Is that unfair? I find it hard to believe it is unfair.

In Senator Domenici's testimony, he touches on some of these same problems. One U.S. producer has calculated that the total U.S. royalty burden stands between 22 and 25 percent, counting Federal, State, county, and even school board levies—that is, on a barrel of oil. The Canadians' is dramatically less.

And yet, I have trouble believing that that is unfairness on the part of the Canadians. I don't think the Canadians are required to adopt every tax that we impose in the United States.

Now, a subsidy, it seems to me, is where the Federal Government or the provincial government—whatever it might be—gets in there and rewards somebody for searching for oil. But I do think it is important for us to bear those distinctions in mind as we go through this, Mr. Chairman.

I don't have any questions for either of these gentlemen.

Mr. Hiney, I was interested in your testimony. In my section of the country we are very dependent upon that Quebec power. More and more is coming in, and we look for more to come in. So I found your testimony of interest, in what is taking place in your particular section and in the areas that you have responsibility for.

Thank you, Mr. Chairman.

Senator **Moynihan**. Thank you, Senator Chafee. Senator Baucus.

Senator **Baucus**. Thank you, Mr. Chairman.

Mr. Altmeyer, following up the point of Senator Chafee—namely some assistances are impediments or subsidies and some are not—that is, certainly a tax exemption would be more in the nature of a subsidy to an industry, whereas a requirement to pay a Black Lung fee may not be a subsidy indirectly if it is placed on the other country's industry and not on the domestic industry.

Looking at the classic definition of "subsidies," direct payments by the Federal or Provincial governments or to tax exemptions to either the coal industry in Canada or to the utilities in Canada, on balance is the American coal industry in your judgment better off or worse off under this agreement looking at the classic definition of subsidies that affect directly or indirectly your industry?

Mr. **Altmeyer**. With respect to coal production, we currently have free trade between Canada and the United States; there are no barriers. We are not aware of any classical subsidization of the Canadian coal production.

Senator **Baucus**. What happens when you crank in the utilities?

Mr. ALTMEYER. With respect to the utilities, there are allegations that we have not independently investigated that the Crown Corporations, by virtue of being creatures of the provinces, are exempt from a sales tax or exempt from property taxes. They do not have to pay——

Senator BAUCUS. What about concessionary loans to Canadian utilities? That is, the loans that are given on the condition that the utilities make some money, but don't have to pay it back if they don't.

Mr. ALTMEYER. We would consider that to be a subsidy, Senator.

Senator BAUCUS. I would, too. So, taking that into consideration, those kinds of subsidies also into consideration, is the American coal industry better off or worse off?

Mr. ALTMEYER. We would be worse off as a result of that subsidy.

As Mr. Hiney points out, even with that subsidy, coal fired power in the United States is not going to compete with the cost of hydroelectric power from Canada. The subsidy could make a marginal difference, though, on a utilities decision whether to import power, taking other factors into account. However, the subsidization does give some advantage to Canadian Crown Corporations.

I should also point out that hydroelectric power is not the only source generation of power exported into the United States. In New Brunswick Province they are constructing a 1000-megawatt nuclear power unit that possibly could not be built in the United States. It will be dedicated to export to the United States.

In Ontario, Ontario is constructing new nuclear power units that are paid for and constructed by the Federal Government and turned over to be operated by the provincial utilities. The provincial utilities have to repay the Federal Government after they are constructed; but that power also will be coming into the United States.

Senator BAUCUS. Have you looked at or drafted implementing language that you suggested to the USTR, and if so, how accommo- [illegible] have they been in agreeing to your suggested changes in [illegible] implementing language, to try to correct some of these [illegible]?

[illegible] ALTMEYER. We have not drafted implementing language, [illegible] We are exploring what language could be possibly put into the implementing legislation to address our concerns.

Senator BAUCUS. How far along are you in reaching an agreement with the administration?

Mr. ALTMEYER. With respect to the administration we haven't even begun to reaching an agreement.

Senator BAUCUS. That is, they are resisting your suggestions?

Mr. ALTMEYER. They have shown empathy. But basically they have said that subsidies were an issue that we could not get to the table before January 1; it was an important issue; the reason 1907 is in the Free Trade Agreement is because we recognized we could not come to terms with the Canadians on the subsidy issue and still meet the January 1 deadline. They are looking to this Committee and the Congress to provide them guidance on what should be done on the subsidy question.

Senator BAUCUS. Thank you.

Senator MOYNIHAN. Senator Heinz, you may wish to ask some questions.

Senator HEINZ. Yes. Mr. Chairman, thank you very much. I think I can be brief, because Senator Baucus and Senator Rockefeller covered a lot of what I wanted to address to Tom Altmeyer.

Tom, we have all noted your points on the differential in taxation between the coal industry here and the coal industry in Canada.

You have been quite candid in explaining the extent to which subsidies are and are not a problem, and in your comments to Senator Baucus you described, I think with great clarity, what takes place at the utility level, which should be cause for concern.

The one issue that we haven't yet spent a lot of time on but on that I have been persistently concerned about is the issue of what could happen if the provinces exercise what they believe is their due right under the Canadian Constitution to restrict or impede trade.

Could you indicate, since you have said that by and large at this point trade in coal is quite free on both sides, what you might be concerned about, what kinds of practices would be possible and prejudicial? And I guess you are going to have to do this quickly, because I am running out of time.

Senator MOYNIHAN. Gentlemen, you have 2 minutes. I will bet you can do it.

Mr. ALTMEYER. The concern would be—and it is a concern of the U.S. domestic utility industry, companies such as that of Mr. Hiney's—we are concerned because we would hope to sell our product to them.

Under the Free Trade Agreement there is nothing. Once a utility commits to a long-term firm power project defers constructing its own generation capacity, basically it is hooked on that Canadian power. There is nothing in that agreement to stop that Canadian utility from increasing the price of that power over the term of the contract.

Despite the proportional language in Article 90 which references GATT the only time Canada would be prohibited or that proportional language would be triggered would be when they are stating that they are suffering from a national shortage. If they don't chose to invoke that provision of the GATT, they could increase the price of power if allowed under the contract. The only remedy available to a U.S. utility would be I presume, in the courts of the United States or in the courts of Canada whichever had jurisdiction over those contractual terms.

Senator HEINZ. One specific and last question: Are you at all concerned about the possibility of any quantitative restrictions on U.S. coal exports being imposed by provinces in Canada at some future time? Or is that simply a hypothetical problem?

Mr. ALTMEYER. We are not concerned with the quantitative restriction; however, the Canadian coal industry has lobbied in Canada with the Ontario Province to try to place a tax based upon the level of sulfur and coal, to force Ontario Hydro not to construct scrubbers to meet their clean air requirements but to import British Columbian coal. We are concerned.

Senator HEINZ. Thank you, Mr. Chairman.

Senator **Moynihan**. Gentlemen, we thank you for excellent testimony, very quantitative and informative.

The Committee will stand in recess.

Would the next panel have the goodness to form and be at the table when we return?

[Whereupon, at 11:08 a.m., the Committee was recessed.]

AFTER RECESS (11:15 A.M.)

The **Chairman**. This hearing will come to order. The next panel will consist of Mr. Nicholas Bush, President of the Natural Gas Supply Association; Mr. Danny Conklin, Chairman of the Independent Petroleum Association of America; Mr. Charles Gentry, Vice President of TIPRO; Mr. William McCormick, the Chairman and Chief Executive Officer of Consumers Power Company, on behalf of the American Gas Association; and Mr. John Buckley, Vice President of Marketing, Gulf Oil, a division of Cumberland Farms, on behalf of the Citizens for the Canada-U.S. Free Trade Agreement.

Gentlemen, what we are going to be receiving in this particular panel are those witnesses concerned with the energy aspects of the Canadian Free Trade Agreement.

OPENING STATEMENT OF HON. LLOYD BENTSEN, A U.S. SENATOR FROM TEXAS, CHAIRMAN, COMMITTEE ON FINANCE

The **Chairman**. Canada is virtually the only supplier to the United States of natural gas and electricity today from outside of our boundaries, and it is the leading foreign supplier of oil and uranium. But one of the concerns, of course, is that this country is a major supplier of those kinds of products, a major producer of them.

And as we learned in 1973 and in 1974, energy is absolutely basic to the health of our economy. So it is quite natural that this Committee is going to look very carefully into the energy aspects of that agreement.

As we study that agreement, a few things become clear in several sectors. While that agreement strips away many of the traditional barriers, particularly when you are talking about customs duties, it leaves in place many of the domestic programs that distort the competitiveness of initiatives on both sides of that border.

Too often we find our producers have a burden limiting their competitiveness, or their Canadian competitors have a benefit enhancing their competitiveness, or both. To some extent at least this is true in the energy sector.

We cannot and we should not imitate every Canadian subsidy and nontariff barrier. Our domestic production ought to stand and fall on its own merits. And while Canada is our largest trading partner, our businesses have to compete worldwide, not just with Canada.

However, if opening these markets distorts trade rather than freeing it because of Canadian domestic policies, then we have to examine how we can keep from having unfair harm to our critical industries.

So I hope that these witnesses this morning will speak to some of those issues. I know they are deeply concerned and we have chosen people that we think are authorities in their particular fields.

The first witness I am going to call on is Mr. Nicholas Bush, President of the Natural Gas Supply Association, Washington, DC. Mr. Bush.

STATEMENT OF NICHOLAS BUSH, PRESIDENT OF THE NATURAL GAS SUPPLY ASSOCIATION, WASHINGTON, DC

Mr. BUSH. Mr. Chairman, I am Nicholas J. Bush, President of the Natural Gas Supply Association, a national organization comprised of independent and integrated domestic producing companies that market roughly 90 percent of the nation's gas production.

Mr. Chairman, we appreciate the opportunity to comment on the pending U.S.-Canada Free Trade Agreement, and in particular on its potential impact upon domestic gas producers and U.S. gas markets.

If there is no objection, Mr. Chairman, I would ask that my entire statement be put in the record.

The CHAIRMAN. The entire statement will be put in the record.

Mr. BUSH. The Natural Gas Supply Association wholeheartedly endorses free, equal, and open energy trade between the United States and Canada, and we do so for reasons which extend beyond our sincere commitment to the principles of free market and free trade.

Domestic gas producers benefit when there is a flourishing market for their product. Experience has shown that such a market results from strong consumer confidence. It is immensely beneficial to all segments of the natural gas industry when end users are confident that the prospects for acquiring future supplies to meet reasonable demand expectations are good, and that consumers will be able to compete for access to all competitively-priced supplies that serve their markets.

Most energy forecasts conclude that competitively-priced imports of Canadian natural gas may make an important contribution to meeting future U.S. energy needs. Thus, to the extent that the FTA reassures U.S. consumers that future natural gas supplies from Canada will not be unfairly restricted or unreasonably priced, the agreement may contribute actually to a more stable long-term U.S. gas demand and to a larger natural gas market than would otherwise exist, absent such assurances. And domestic gas producers want to compete in a growing gas market.

The members of the Committee are aware, however, that NGSA and other natural gas producing associations have expressed concern about the ability of domestic gas producers to freely compete with their Canadian counterparts.

Some Canadians have said that these concerns about being able to compete fairly—or to use the phrase, a cliche, "on a level playing field"—are actually the wolf of protectionism trying to dress itself in the innocuous cover of sheeps' clothing. Nothing could be further from the truth. The willingness of domestic gas producers to compete with our Canadian counterparts for U.S. markets is sincere; but it would be irresponsible to leave this Committee or the

Congress with the impression that when the Free Trade Agreement is adopted, U.S. producers will necessarily be able to compete on an equal footing with their Canadian counterparts. Equal footing depends upon whether the U.S. Government is willing to take specific action that would allow domestic producers to take advantage of new exploration production and marketing opportunities.

U.S. oil and gas development and, as a result, domestic producers are still restricted by several important U.S. Government policies which must be changed if the Nation is to benefit from its remaining significant energy resource potential.

Canada has actually responded to changing energy market realities more completely and on a more timely basis than the United States. Natural gas is totally deregulated at the wellhead in Canada, while certain price and nonprice controls remain in effect on natural gas at the wellhead in the United States.

Statements are sometimes made that in the current highly competitive U.S. wellhead market for natural gas, total deregulation is less important. We do not agree.

Total wellhead deregulation of natural gas would result in the eventual development of significantly more domestic reserves, reduction in the use of imported oil, and a lessening of the trade deficit. Total deregulation of natural gas at the wellhead would enhance domestic producers' long-term ability to compete with Canadians.

As important, there are several issues before the Federal Energy Regulatory Commission which may determine the competitiveness of domestic U.S. gas producers. The Commission is currently considering a final rulemaking, for instance, on open-access transportation of natural gas on interstate pipelines. Achieving a non-discriminatory, open-access national transportation system is very important, almost critical, for natural gas producers and consumers, and NGSA has strongly supported FERC's efforts in this regard.

The Commission's interim transportation rule, Order No. 500, however, contains an extremely damaging requirement called cross-contract crediting which, if incorporated in the final rule will have a negative impact on domestic gas development, and will put domestic producers at a serious disadvantage in competing with Canadian gas, to which the contract abrogation provisions of Order No. 500 will not apply.

Appended to my testimony, Mr. Chairman, are NGSA's most recent submissions to the Commission on Order 500, and I would encourage you to look at them.

The Federal Energy Regulatory Commission, as a general rule, is also not allowing the recovery of take-or-pay settlement costs in pipeline demand charges. But take-or-pay settlement costs associated with Canadian contracts have been permitted by FERC to be placed in pipeline demand charges In an environment in which natural gas sales are won and lost because of a few pennies difference, this inconsistent policy is not unimportant. If domestic gas is to be competitive, a policy that treats settlement costs equally is needed.

The Committee may also be familiar with frequent references by the domestic producing industry to the importance of FERC's Opinion No. 256. Simply stated, Opinion No. 256 decreed that U.S. interstate pipelines could no longer pass through certain costs of Canadian gas in the demand charge of their rate structure for which similar costs of U.S. gas were not allowed to be passed through in the same manner.

Opinion 256 is very significant to domestic producers who try to compete against Canadian gas, particularly from the Southwest into the critical California market.

For years, domestic producers who serve the El Paso and Transwestern systems into California, as well as California producers serving their own markets, have competed against Canadian gas, which has taken advantage of that price differential.

Mr. Chairman, thank you for entering my entire statement. The balance of my remarks advocates—repealing of the Windfall Profits Tax, consideration of some of the United States public lands policies, of resource development, of oil and gas development—all of them are significant and critical to U.S. gas production, and we would encourage you to examine them very, very carefully.

Thank you.

The CHAIRMAN. On the repeal of the windfall profits tax, you are kind of carrying coals to New Castle. (Laughter)

Thank you very much, Mr. Bush, and I want to ask you some questions on your testimony in a moment.

Mr. Danny Conklin, an old friend of mine who has shown a great deal of leadership in his industry and given much of himself in public causes for his community.

We are pleased to have you.

STATEMENT OF DANNY CONKLIN, CHAIRMAN, INDEPENDENT PETROLEUM ASSOCIATION OF AMERICA, AMARILLO, TX

Mr. Conklin. Thank you, Mr. Chairman.

I am Danny Conklin, a partner in Philcon Development Company of Amarillo, TX. We are a crude oil and natural gas exploration and production company which realizes 85 percent of its revenues from wellhead sales of natural gas. I appear here today a Chairman of the Independent Petroleum Association of America.

I would first like to throw some thank-yous to the Chairman, and for his leadership in regard to the windfall profits tax and the work he is doing on the Trade Bill. We independents appreciate that.

We also appreciate this opportunity to appear before you on the subject of the pending proposed United States-Canada Free Trade Agreement.

At the outset, let me say that on its face, the Free Trade Agreement does not change the ground rules of natural gas trade with Canada. As normally understood in the meaning of "free trade," we currently have free trade with Canada. The Free Trade Agreement does not make any significant changes in the status quo. However, for some time we have not had fair trade, and the Free Trade Agreement does nothing to remedy inequities in the regulatory scheme of gas production and transportation which is creating the inequities.

Thus, the IPAA believes that the current debate over the Free Trade Agreement and the focus it gives to the United States-Canadian relations is an excellent setting in which to seek fair trade.

When you look at the history in regard to energy, the Canadians have not been complacent suppliers of energy to the United States and have protected their own self-interests both as to price and availability of their exports.

We should not forget that during the crude oil shortages following the 1973 Embargo, Canada severely limited its crude oil exports to the United States; and later, in the 1970s when the United States faced natural gas curtailments, the Canadian Government intervened in private contracts at the border to establish a floor price which reached as high as $4.95 per MMBtu. That was approximately three times the average United States price for natural gas and four times the controlled price in Canada for intra-Canadian sales at the time.

So when supplies are tight, the Canadians either have refused to sell to us or have limited the amounts sold and demanded above market prices. Yet, as now when the United States markets are soft the Canadians claim that the reliability of their supplies justify prices which are in excess of the unit price of available domestic supply.

According to the Energy Information administration, the average wellhead price of domestic gas in August was $1.71, while the imported average gas price for that month was $2.17. Similarly, the EIA's projected surplus deliverability of domestic gas is 1.4 trillion for the 6-month period beginning October of 1987. Notwithstanding this deliverability surplus, a total of 850 Bcf of gas was imported during 1987.

And the words "reliability" and "stability," my point in bringing these things up is that we do not want to forget that the reliability and stability of the domestic gas reserves are already here.

The agreement, does not mention natural gas. Instead, it is drafted in terms of energy goods, and it uses definitions from the General Agreement on Tariffs and Trade.

We support the specific objectives listed in the Preamble of the Agreement, including "to reduce government-created trade distortions while preserving the parties' flexibility to safeguard the public welfare".

I also note that Article 102 lists as an objective to facilitate conditions of fair competition within the free trade area. However, many practices and policies which presently provide Canadian gas with unfair advantages will have to be corrected if these worthy goals are to be achieved.

On item conspicuously absent from the regulatory changes is the Commission's decision in the Natural Gas Pipeline Company of America Opinion 256. We have been assured by the administration that this indicates that nothing in the Free Trade Agreement will overturn this important Commission action.

Accordingly, we urge the Congress to clarify, in the course of developing its legislative history on this Agreement, that Opinion 25 remain intact.

The Alaskan Gas Transmission System is creating a problem as far as the Northern Border Pipeline, Senator, and we would appreciate it if these things were looked at and studied, and that the so-called "level playing field" be examined in regard to the Northern Border Pipeline.

I think as we conclude, though, while we know it is not covered by the Agreement, we did want to bring to your attention some existing discrepancies in the tax treatment of Canadian and U.S. producers.

We know that the negotiators agreed not to try to assess the relative equity of the two nations' tax codes and production incentive programs. Instead, they provided a mechanism for aggrieved parties on either side of the border to seek trade relief action.

However, again, in the interest of fair trade at the time we are talking about free trade, we urge the Congress to consider significant changes in the Tax Code to put U.S. producers on a more even footing with their Canadian counterparts.

The **CHAIRMAN**. Mr. Conklin, now your time has expired. I will have to ask you to summarize.

Mr. Conklin. Thank you, Senator.

[The prepared statement of Mr. Conklin appears in the appendix.]

The **CHAIRMAN**. Thank you.

Mr. Gentry of TIPRO, we are pleased to have you testify.

Senator **BRADLEY**. Mr. Chairman, is this the last panel?

The **CHAIRMAN**. Yes.

Senator **BRADLEY**. Thank you.

STATEMENT OF CHARLES GENTRY, VICE PRESIDENT, TEXAS INDEPENDENT PRODUCERS AND ROYALTY OWNERS ASSOCIATION (TIPRO), DALLAS, TX

Mr. **GENTRY**. Mr. Chairman and members of the Committee, my name is Charles Gentry, attorney and partner in a Dallas law firm, and my practice is primarily representing independent producers of oil and gas in Texas and the Rocky Mountain area.

I appear here today as Regional Vice President of the Texas Independent Producers and Royalty Owners Association TIPRO, which is composed of some 4,000 members with an interest in oil and gas in Texas. At the times I have appeared here in the past or in the Congress in the past representing TIPRO, we have had a larger membership, in the past as high as 7,000. Now it is 4,000.

Many of our members compete directly with Canadian gas exports in both the West Coast and Midwest markets, and therefore have a direct concern with national policies relating to Canadian imports of natural gas, oil, and petroleum products.

I request, Mr. Chairman, that a copy of my complete statement previously submitted to the Committee be made a part of the record.

The **CHAIRMAN**. That will be done, Mr. Gentry.

Mr. **GENTRY**. TIPRO understands and appreciates the long standing harmonious trade relationship that has existed between the United State and Canada. The benefits of this relationship for both countries are obvious. There is considerable merit, therefore, in the effort of the administration to initiate workable trade principles in a Free Trade Agreement with Canada.

It is our contention, however, that trade policy affecting strategic commodities is important to the national defense objectives, such as petroleum and petroleum products, should be guided by standards which are quite apart from and in addition to free trade objectives applying to other commodities. We believe, for example, that natural gas provided by a foreign source, no matter how friendly it might be, should be subject to national security objectives and concerns as opposed to some other products that might fall more under the free trade objectives and analysis.

In TIPRO's opinion, the trade agreement provisions relating to energy should have reflected more carefully the desired objective of maximizing utilization of United States petroleum reserves. The objective is partially impeded if foreign imports are allowed to come in freely and therefore dominate domestic markets that would otherwise be served by a domestic supply. Domestic producers must have optimum market opportunities to assure the economic ability necessary to maintain adequate exploration for and development of natural gas reserves.

Trends in U.S. natural gas production and Canadian imports in recent years, along with anticipated growth in imports in the near future, indicate that imports are winning the battle for marginal U.S. markets. This is happening during a period in which most experts believe that excess U.S. producing capacity is more than 20 percent higher than the demand.

I have in my prepared statement figures and statistics which demonstrate this trend that I have just mentioned.

At the very least, TIPRO believes that domestic gas producers should have an equal opportunity, in competition with imports, to serve home markets. This equality may be impossible to achieve under the energy provisions of the Trade agreement, because current inequities in applicable tax laws and energy laws and regulations between the United States and Canada are not addressed. Unless enabling legislation finally approved by Congress addresses these inequities and authorizes changes necessary to provide a truly level playing field are acceptable once the Trade Agreement is finalized the possibility of substantial growth in Canadian imports at the expense of U.S. production persists for the foreseeable future.

Perhaps the most important of the inequities that must be addressed is the need to preserve the Federal Energy Regulatory Commission's Order 256, which was mentioned by Senator Domenici earlier this morning and by others on the panel. This order attempts to equalize regulatory rate design between Canadian gas imports sold interstate in the United State and domestic production also sold interstate. While provisions of this Order are arcane and very complex and are not of very much interest to the non-gas regulator, the bottom line is eminently clear: The Order eliminates a substantial economic advantage formerly held by competing imports.

But much work remains to be done to extend this element of fairness to California, Minnesota, and New England gas markets, just to name a few. These markets are served by Canadian supply that also competes with domestic supply but, for institutional reasons, is governed by the Economic Regulatory administration, the ERA, of the Department of Energy rather than FERC.

The corrective measures of Order 256 have yet to be applied by the administration to import sales governed by ERA. Unless this is accomplished prior to the finalization of the Trade Agreement, either through administration action or through inclusion by Congress in enabling legislation, TIPRO is convinced that there will be little hope that it will be addressed successfully at a later date.

We urge the Committee to review the provisions, the issues, and the points raised in the Domenici legislation. And in that process, we urge that the Committee not become sidetracked by trying to determine what is a subsidy, in either the classic sense or otherwise, and what is some other kind of incentive, and whether those items are fair or legitimate when viewed in isolation or standing on their own terms.

The Committee should ask of each item, where there is a difference of treatment between United States and Canadian producers, whether that item gives a competitive advantage to the Canadian producer compared to the United States producer. If so, it tilts the playing field in favor of the Canadian producer.

In conclusion, Mr. Chairman, we strongly believe the long-range security interests of our nation require that domestic development of crude oil and natural gas strategic commodities, should be enhanced rather than impeded or endangered by foreign trade agreements, however otherwise desirable. Thank you, sir.

[The prepared statement of Mr. Gentry appears in the appendix.]

The CHAIRMAN. Thank you very much, Mr. Gentry.

Mr. William McCormick, who is Chairman and Chief Executive Officer of Consumers Power Company, on behalf of the American Gas Association.

Mr. McCormick?

Senator RIEGLE. Mr. Chairman, before he speaks, I wonder if I might make a comment about Mr. McCormick.

The CHAIRMAN. Yes, of course.

Senator RIEGLE. Thank you.

I want to particularly take the opportunity to welcome him before our Committee today. I think he has really done an exceptional job of running Consumers Power at a difficult time of transition. Of course, he appears here today on behalf of the American Gas Association.

His company represents about 6 million of my constituents, Mr. Chairman, so I want to listen with great care to what he has to say today.

The CHAIRMAN. We are delighted to have him.

STATEMENT OF WILLIAM McCORMICK, CHAIRMAN AND CHIEF EXECUTIVE OFFICER, CONSUMERS POWER COMPANY, ON BEHALF OF THE AMERICAN GAS ASSOCIATION, JACKSON, MI

Mr. McCORMICK. Thank you, Mr. Chairman, and thank you, Senator Riegle, for those generous comments.

My name is Bill McCormick, and I am Chairman and Chief Executive Officer of CMS Energy Corporation and its principal subsidiary Consumers Power. As the Senator mentioned, we supply 6 million of the 9 million citizens of Michigan with gas, electricity, or both.

Today, however, I am representing the American Gas Association, which is a national association which represents 300 gas transmission and distribution companies throughout the United States. In this connection I chair the American Gas Association's Gas Supply Committee and have also acted as Co-Chairman of the American Gas Association/Canadian Gas Association Joint Task Force on the Free Trade Agreement.

First of all, AGA strongly supports the Canadian/U.S. Free Trade Agreement, because we believe it will enhance the vital role that the natural gas industry can play in meeting this nation's energy, security, economic, and environmental goals, and the role of the Free Trade Agreement in achieving those goals.

I think the problem that we have seen in the past between Canada and the U.S. with respect to natural gas has been interference by government and regulatory agencies on both sides of the border.

I think my colleague on the panel mentioned the insecurity of Canadian supplies and the fact that there have been price adjustments during those terms by government. And I think the whole purpose of the Canadian/U.S. Free Trade Agreement is to provide a framework where the kinds of problems that we have seen in the past, where retroactive government intervention and regulatory changes will be prevented, and there will in fact be sanctity of contract during the term.

Free Trade Agreement can assure that long-term reliable supplies of natural gas will not be hampered or disrupted by retroactive regulation, and a secure uninterrupted supply of natural gas has implications for other U.S. policies.

I want to outline five specific benefits of the Free Trade Agreement:

No. 1 is national security. Increasing U.S. natural gas use and our gas trade with Canada will reduce U.S. dependence on oil from the politically-unstable Middle East. Natural gas from Canada only supplies approximately 4 percent of our gas requirements at the present time. Increasing these gas supplies could replace 350,000 barrels of imported oil per day immediately, instead of 120,000 barrels per day within 1 year. Over 5 years, additional gas supplies could displace 1.7 millions barrels per day.

No. 2 is the balance of payment. Aside from the national security benefits of oil displacement, increased gas use would improve our balance of trade.

Oil at the border is 50 percent more expensive than natural gas. If gas displaced oil at rates that I have outlined, the United States would reduce its trade deficit by more than 200 million per month immediately and up to 1 billion per month within five years.

No. 3 is enhancing U.S. gas supply security. A recent DOE study maintains that natural gas is the most substitutable fuel for oil and that the United States has plentiful long-term supplies. These supplies can be enhanced by supplies from Canada. In fact, Canadian supplies of proved reserves and potential resources were almost double the reserves and resources that the United States currently has at its disposal.

By our estimates, in the year 1990 natural gas energy will be some 50-percent greater than lower 48 State oil produced energy. So, increase demand in the exploration incentives producers need, and the entire nation will benefit.

No. 4 is the economic benefits of energy to energy users. More secure energy supplies will mean lower energy prices over time.

My company supplies some of the largest industrial energy users in the United States, in automobile, steel, and chemical. These benefits of more competition, more supplies, and lower cost can translate into U.S. goods and services and products that are more competitive in the world market.

An increase in the source of supply will mean more competition which in turn will bring lower long-term prices to major energy users, and these will allow them to compete more effectively in world markets

These include such industries as automobiles, steel, and chemicals, which we serve.

And No. 5, I think the increased supplies of gas from Canada are in the national interest are the environmental and efficiency advantages of natural gas. Because it is a clean-burning fossil fuel, using gas has definite environmental benefits which will allow us and allow the nation to meet its increasingly stricter environmental requirements as time goes on.

I think with respect to Order 256 and 500, we ought to leave that to the FERC. It is really a separate matter from the Free Trade Agreement.

In conclusion, I firmly believe that the energy sections of the Free Trade Agreement will benefit consumers, producers, industry, and electrical customers as well as natural gas distributors and pipelines both in the U.S. and in Canada.

I urge this Committee and the Congress to consider the long-term benefits for our nation of enactment of the Free Trade Agreement, with its significant economic benefits.

I would request that my full testimony be entered into the record. Thank you.

[The prepared statement of Mr. McCormick appears in the appendix.]

Senator RIEGLE. We will make your testimony a part of the record, and we thank you for your statement.

Mr. Buckley, we would like to hear from you now.

STATEMENT OF JOHN G. BUCKLEY, VICE PRESIDENT OF MARKETING, GULF OIL, A DIVISION OF CUMBERLAND FARMS, ON BEHALF OF CITIZENS FOR THE CANADA-UNITED STATES FREE TRADE AGREEMENT, WESTBORO, MA

Mr. BUCKLEY. Thank you, Mr. Chairman

My name is John Buckley. I am Vice President of Wholesale Marketing for the Gulf Oil Division of Cumberland Farms, and I am here to testify on behalf of a group of independent petroleum marketers who sell refined products, primarily gasoline in every State along the northern border from Maine to the State of Washington—the border with Canada.

I think if there is one key principle underlying this proposed agreement it is that economic factors rather than political or regulatory questions will have greater sway in determining energy trade and investment decisions in both countries.

I would like to identify six specific benefits:

First of all, while there will still be government intervention in the marketplace and interference, there will be greater certainty that economic rather than fluctuating government policies will define these two energy markets.

Current levels of government intervention will be locked in and will become the maximum permitted. In the meantime, there are mechanisms already in place to further reduce nontariff barriers to trade and investment, and the administration certainly has indicated they intend to chip away at those barriers.

Second, it is clear that the long-term commercial and investment relationships will grow. On the oil side we don't expect anything dramatic initially, but gradually a more logical and economic binational energy flow will result and will grow.

Third, with the achievement of economic efficiencies along the border, Canadian oil will provide a useful check on domestic U.S. oil prices. Greater competition fosters lower prices and real benefits, both for the independent marketer and for consumers in the two countries.

Fourth, in the event of another major oil trade disruption—and I think really that is a question of not if but when—there will be a reduction of panic-type response and a feeling of increased security as Canadian and U.S. energy economies become more closely tied together in both the short and long term

Fifth I think out over the next decade of this century the closer economic and political relationship between the U.S. and Canada will allow a more rapid development of the apple basket tar sands, heavy oils, United States and Canadian Arctic crude oils, and the major oil fields off the coast of Newfoundland than would otherwise occur. Why? Because a larger and more stable energy market, a North American energy market, and improved investment climate sharply reduces risk.

Development costs of most of this hydrocarbon resource are very high. If you add a risk factor, development is very slow. If you reduce the risk, development is faster.

Finally, out over the midterm, the next several years, it is clear there is plenty of crude oil available in the world; but here in the United States we are importing higher volumes each years. Moreover, if you look at the statistics for recent months, the last 4 or 5 months, Saudi Arabia has once again become our largest single supplier of foreign oil, replacing Canada. This agreement won't change that fact overnight, but it does establish a foundation to gradually build energy ties, expand Alaskan oil sales to Canada and Canadian oil sales to the border areas in the United States.

Mr. Chairman, we have heard a lot today about a level playing field.

I have no problem with any of the proposals—the elimination of regulation of natural gas, the elimination of the Windfall Profits Tax, which this Committee is working on, the opening up of Anway reserves in the north slope, providing of tax incentives to domestic industry. I have no problem with any of that. But that is part of our domestic agenda. It has nothing to do with this agreement.

This agreement doesn't change our national agenda. We need to address those problems, and we support addressing those problems and changing those policies. But a veto of this bill doesn't advance those policies a bit.

This agreement, Chairman Moynihan said at the beginning of the meeting, is a historic agreement. And I think it is, no only in the commercial and foreign economic policy of the United States is it significant, but four times since the year 1812 we have tried to develop a free trade area between the United States and Canada. All four attempts have failed. Now we have another opportunity.

This agreement does provide for a binational panel to resolve disputes and a framework to ease the nontariff barriers.

It is not perfect. No trade agreement ever is. But it does bring the Hawley-Smoot Tariff levels established in 1930 to zero on all trade between Canada and the United States.

Of course there will be winners, there will be losers, on both sides of the border. But the phase-out is gradual, in the most severe cases 10 years.

When you add up the real winners, I think those winners will be the people of Canada and the people of the United States.

This policy and this agreement represents good trade policy, good economic policy, and good energy policy. If I compare this agreement to where we are today, and if I could just offer three words of advice to this Committee, those three words would be "Go for it."

[The prepared statement of Mr. Buckley appears in the appendix.]

Senator RIEGLE. Thank you, Mr. Buckley. It is obvious that you have got a well-defined point of view on this, and you express it very well.

There will be questions for all of you, I think, by various members of the Committee. We have a number of things going on; we have the budget on the floor today, as you may have been told earlier, and as well we have got very serious negotiations going on to try to complete the general large Trade Bill. And that requires a number of the members of the Committee who were central to that process to be involved in those final negotiations, literally, as we meet this very minute.

Mr. McCormick, I would like to take you through a series of questions, as they relate to how the Trade Agreement might impact the State of Michigan specifically.

It is my understanding that Michigan produces about 11 percent of our natural gas needs from within the State. Much of the remaining supply comes through interstate pipelines from the South and Southwest. How many Bcf of Canadian natural gas are we using today?

Mr. McCORMICK. I would say, on a percentage basis, we are probably using about 10 percent or less—between 5 and 10 percent of the total gas for Michigan is coming from Canada at the present time.

Senator RIEGLE. And how do you think that would change if the Agreement is approved?

Mr. McCormick. I think it would be increased. It would definitely not, in my judgment, be at the expense of the United States producers. I think the additional gas supplies would displace oil and other fuels in Michigan.

One of the advantages of Michigan geographically is that it is close to Canada and therefore it is a very economic and convenient place to introduce Canadian gas

I think the benefit would be to the Michigan economy and to the Michigan industrial users. They would have access to an additional supply of very competitive natural gas which could displace oils and other fuels and lower their cost of production in the State.

Senator Riegle. Would you estimate how much of our total gas usage in Michigan will come from Canada, over a 10-year period of time if the agreement is approved?

Mr. McCormick. I think the 5 or 10 percent could go to 15 percent over the next 10 years. At the present time, as I mentioned before, about 4 percent of the total gas used in the United States comes from Canada. That is about 700 billion cubic feet on an annual basis.

There is currently pipeline capacity to move about 1.7 trillion, to increase that by roughly two and a half times. So, current pipeline capacity could increase that to approximately 10 percent of our current national usage.

I think in Michigan it would be a little bit higher than that, because it is geographically situated to take that.

Senator Riegle. Would we need much if anything in the way of new infrastructure in Michigan to take additional supply from Canada such as pipelines or storage facilities?

Mr. McCormick. There would be very little necessary. The current pipelines that go into Michigan—the Great Lakes Gas Transmission and the American Natural System as well as the Panhandle System—A&R and Panhandle interconnect with several other pipelines coming from Canada, Midwestern and Trans-Canada. Those pipelines have capacity to move substantially more supplies than they do today.

In my judgment, there would be very minimal additional requirements.

Senator Riegle. What would be the view of the Gas Association with respect to the net impact on domestic exploration and production assuming the Agreement goes into effect?

Mr. McCormick. Well, it is our view that it would not adversely impact it. As a matter of fact, it could enhance it in certain ways.

The reason for that is, one of the difficulties of natural gas has been a perception among some industrial users that future supplies are uncertain. I think bringing the Canadian resource base and making it available in effect to the United States would allay some of those concerns and enhance the prospect for more long-term contracting between producers and users.

As I mentioned, I think the additional supplies from Canada would also largely be used to displace oil, foreign oil, throughout the United States. As I mentioned, going up to the full 1.7 trillion cubic feet could result in the elimination of about a million barrels a day of oil imports, and that would be very substantial.

I think the treaty, although some of the gas producers have concerns about it, I personally believe it will be beneficial to the gas industry, all segments of it.

Senator **Riegle**. If you take the northern tier States, which of course includes Michigan, is there a particular advantage to those area of the country in terms of this kind of a new energy connection in your view?

Mr. **McCormick**. Well, there is, because those States are geographically close to Canada and the farther you have to go into the interior of the United States, the more it costs to transport Canadian gas there.

On the other hand, Michigan is pretty far from the Gulf Coast and Texas and some of the U.S. gas-producing areas, and our transportation costs from those areas are higher, which makes energy costs in our State from those sources at a competitive disadvantage to States in the South who are large producing States.

So I think, from the standpoint of the Midwest and the upper tier States, access to secure Canadian supplies is good for energy users and will result in the long run in lower energy costs, a better competitive situation for those industries both in the United States and in the world trade.

Senator **Riegle**. Let me ask you to just comment on the issue of something that would interrupt supply later on down the line, some kind of genuine emergency or some problem that would cause the Canadians to strongly feel that they need to keep their gas at home after we had come to rely on an increasing part of it.

What is your view on how the treaty works in that area? Is it sufficient, in your view, or are there soft spots?

Mr. **McCormick**. I think it is sufficient, and I think that was a key and major issue of the negotiations from the U.S. standpoint because one of the major concerns of course is that they would increase their price or reduce the volume across the border in some arbitrary fashion. And the provision that addresses this provides that, in the event of a Canadian energy shortage, they must continue to supply their American customers, and they must only make reductions on a pro rata basis to all of their customers both in the United States and in Canada.

So, if they have to make a 10-percent cutback because they don't have the energy, then they would cut back Canada 10 percent and the U.S. customers 10 percent. So there would be no discrimination with respect to curtailments if an emergency situation happened.

I should say in the same breath that that is somewhat theoretical, because the gas reserve picture in Canada relative to their production is three or four times better than the United States. Our current reserve life index in this country is only about a third of what it is in Canada, which means that there are large Canadian reserves relative to their production, so that this wouldn't be a consideration for some time in any event.

Mr. **Buckley**. Mr. Chairman, if I could just add to that, that provision also covers oil, crude oil, refined products, all energy imports. It is not just gas. So there is a great deal more security built into those provisions across the board than we have right now without the agreement.

Senator **Riegle**. Well, thank you very much for your responsiveness.

The **Chairman**. Thank you very much Senator Riegle.

I apologize to you gentlemen for having to leave the room from time to time. We have been very much involved in negotiations on the Trade Bill, trying to finish that one up.

Mr. Bush, you heard a number of comments about FERC Order 256 and having them conform to FERC billing processes, and I heard a number of comments about it.

But there has been some feeling that we could have the undoing of that particular order by appealing to the Binational Tribunal. What is your feeling concerning that?

Mr. **Bush**. Senator, it is a serious concern for domestic gas producers. Opinion 256 righted what was a very difficult situation for domestic gas producers trying to serve into the critical California market and in the Northwest.

You see while Canadian gas represents only 5 percent of the imports in the United States, it represents a very significant competitor in California and the Pacific Northwest. Heartland of the United States in a large measure and in the Northeast.

So it is important to understand that, while it is small nationally, it can be a very effective competitor against domestic producers trying to go into California, for instance.

Opinion 256 has been roundly challenged by the Canadian Government. We would assume that the Canadians will—as Senator Domenici indicated, there are indications in publications, in analyses of the Canadian Government, that challenge 256, through the bi-national resolution procedure.

Our fear there is twofold: One is that it be raised retrospectively, if you would, after it had been put through by FERC; and also that the Binational Resolution Procedure, as I understand it, assumes the power of no further review, that basically it is a five-member panel that sits down and makes an ultimate decision about whether or not this thing fits and is consistent with the Free Trade Agreement. And it is entirely conceivable that in this issue, retrospectively, if there were such a judgment made, the Congress I think ought to be at least considering what the impact would be of having this overturned with no further review either in the U.S. courts, at the U.S. FERC, or in the Congress.

So it is a consideration that we think in some ways the Congress could address probably, in a very efficient fashion, by simply the enabling legislation or separately getting an agreement that States of both nations feel it is consistent or that Opinion 256 is consistent with the Free Trade Agreement. And I think it is a very important factor.

The **Chairman**. It seems to me it is.

Mr. Conklin, as you look at the regulatory schemes that the natural gas industry is subjected to, the producers, pipelines, in this country as compared to that of Canada, when you sift through it all, do you think there is a competitive advantage or to the United States in that regard? And if you think there is a competitive advantage to the Canadians, what do you think we ought to do in this country?

Mr. CONKLIN. I think, as your question to Mr. Bush, Opinion 256 will certainly help us as far as all of us being subject to the same regulations as far as pricing is concerned, when you take a two-part pricing.

At this moment, when the gas is going into California—and I happen to either be fortunate enough or unfortunate enough to compete at the border of California with the Canadian gas—with the commodity charge and the way that the ERA is allowing that to happen at this point, there is a slight advantage to the Canadians.

But then when it goes across into the State of California, then their product is slightly higher than the domestic product coming out of the New Mexico, Texas, and Oklahoma area.

So if we were all subject to the same regulations, Mr. Chairman, I think that we would be fine. I don't think there would be any problem.

The CHAIRMAN. Mr. Gentry, your organization has long fought for the idea of energy independence in the name of national security. Do you think this agreement helps the United States from a national security point of view, or does it create problems? And I wish you would give me some detail in your answer.

Mr. GENTRY. Yes, sir.

Mr. Chairman, on balance, if it is a question of substituting Canadian gas for foreign oil imports, that has got to be a plus.

However, there are questions in our minds about the mechanism, about the relationship between the Canadian Government, the provincial governments, and the commitment and the mechanisms by which the shield that Senator Domenici referred to and the security, the energy security, feeling that we should have that has been referred to by other people here on the panel.

So I think that the agreement would be better than what we have now. But does it allow U.S. producers to compete in the meantime to determine if they can be a part of the developing new areas of gas utilization, or backing out the foreign supplies of oil? And I think on that question the answer is, No, it does not.

But if your question is would we be better off from the security point of view than we are right now, I believe the answer to that is Yes.

Mr. BUCKLEY. Mr. Chairman, could I just add a point to that?

The CHAIRMAN. Sure, Mr. Buckley.

Mr. BUCKLEY. I think what you need to recognize is that every megawatt of hydroelectric power that comes in from Canada, every barrel-equivalent of natural gas that comes into the United States from Canada, every barrel of crude oil, every barrel of refined products all of those energy imports back out other, as a marginal source, other imported oil, and mostly the long-haul crude from the Middle East.

So there can be no question that this agreement tremendously enhances the energy security of the United States in the short term, in the medium term, and in the long term.

To be sure, there are problems here, but those problems we can address in our own domestic agenda, and this agreement specifically provides that both countries can provide incentives to their energy industries, and we can, and we support those incentives.

But to defer or delay or postpone or not enact this legislation this year, to enable this agreement to go forward, would be a tremendous blow to the energy security of this country and I think, therefore, the national security of this country.

The **Chairman**. Mr. Buckley does your company operate in Canada?

Mr. **Buckley**. No. We have a long-term processing arrangement with a Canadian refinery. We don't own the plant. We provide crude to it and take products from it just as we have an arrangement with Chevron at a refinery in Philadelphia.

The **Chairman**. Your company doesn't own minerals in Canada?

Mr. **Buckley**. No.

The **Chairman**. Mr. McCormick, on that point, there are those who would argue that the rules for investment in Canada for American investors are somewhat limited as compared to our rules here. Would you respond to that?

Mr. **McCormick**. I think that is the case. In a number of areas that is the case. And there are no limitations here.

The **Chairman**. Has that been taken car of in this agreement?

Mr. **McCormick**. It has not, but I don't think it is necessary to take care of that. If the United States were to decide that it wanted to limit foreign investment for any reason—national security or any other reason—it certainly has a right to do so.

The **Chairman**. Would you recommend that?

Mr. **McCormick**. I don't recommend it in most areas. I don't think it necessarily would be a wise thing in most areas, but there are certainly some areas where it might be advisable. I don't think it is good policy. I certainly don't think it is.

The **Chairman**. Would you contend that there is equal treatment between the two countries insofar as that?

Mr. **McCormick**. No, I wouldn't say it is equal, Mr. Chairman, but I think there are a lot of things that aren't the same between Canada and the United States—tax rates. You can go through a laundry list of all kinds of areas that are different.

I don't think the fact that the U.S. has limitations on Canadian investment affects the energy crisis any substantial amount. I don't think it really relates to the competitiveness of Canadian energy versus U.S. energy. It is an issue, but it is an issue in a different form.

The **Chairman**. I always thought it was interesting that we had a Toronto newspaper owning a Houston newspaper, but they were violently opposed to a United States company owning Canadian newspapers. (Laughter)

Gentlemen thank you very much. We will go into recess.

[Whereupon, at 12:09 p.m., the hearing was recessed, to resume at 10 a.m. on Friday, April 15, 1988.]

APPENDIX

ALPHABETICAL LIST AND MATERIAL SUBMITTED

Statement of

Thomas Altmeyer
Sr. Vice President, Government Affairs
National Coal Association

on the
Canada - U.S. Free Trade Agreement

Mr. Chairman, my name is Thomas Altmeyer, Sr. Vice President Government Affairs of the National Coal Association (NCA). I am accompanied by William Hynan, Sr. Vice President, Law (NCA), and Connie Holmes, Sr. Vice President Policy (NCA). The National Coal Association is an organization representing producers of coal from the smallest to the largest, operating in all producing regions of the country and mining all qualities of coal. NCA member operations comprise the majority of the commercial coal production in the United States.

We commend you for holding these hearings to explore the effects that the Canada - U.S. Free Trade Agreement (FTA) will have on United States industries and appreciate the opportunity to review the coal industry's position on the FTA.

NCA supports the concepts of free trade that are embodied in the FTA. NCA is concerned, however, that adverse consequences to the U.S. coal industry may result from an increase in electricity imports and/or a dimunition of our ability to compete with Canadian coal producers in U.S. and Canadian markets. Both could result in lower coal production in the United States than would otherwise be expected. Further, a significant question exists on the authority, and thus the ability, of the Canadian federal government to fulfill its commitments where conflicts exist with the provinces. We recommend that the Committee evaluate the concerns raised by these issues in formulation of implementing or companion legislation.

We would suggest four actions, two directly related to consideration of implementing legislation, and two that are separate and apart, that would be first steps in putting the United States and Canada on a more equal basis in the area of coal and electricity.

First, we would suggest that the working group on subsidies established by Article 1907 of the FTA be given specific direction, within time certain, to assess, identify and quantify all subsidies available to either Canadian or U.S. utilities in order to facilitate trade balancing actions.

Second, appropriate agencies should be directed by the Administration to address the federal and state regulatory problems that act as disincentives to the construction and operation of coal fired power plants and constrain U.S. utilities ability to compete with Canadian power.

Third, legislation should be considered to provide U.S. coal producers tax incentives similar to those available to Canadian coal producers.

Finally, the Congress should obtain clarification of the question of the authority, and thus the ability, of the Canadian federal government to enforce the provisions of the FTA in the provinces when conflicts arise between terms of the agreement and provincial law or regulation.

I would like to point out that the United States' coal industry is in a unique position with respect to trade with Canada. Canada is the single largest foreign customer for our coal, importing an average of 15 - 16 million tons annually. However, the potential exists that the coal industry could lose domestic markets as a result of an increase in electricity imports on a firm, or long term contractual, basis. Our thoughts on the Free Trade Agreement must consider both these factors and weigh the advantages of export to a market that could increase with the potential loss of markets within the domestic utility industry.

Since 1970, the United States has experienced a sixfold increase in electricity imports. In 1986, the U.S imported 39 billion kilowatt hours (KWH) from Canada, in 1987, the figure was approximately 47 billion kilowatt hours. In 1986 and 1987, U.S. exports of electricity were 4.7 and 3.5 billion KWH, respectively. This is an outgrowth of a trend toward long term firm supply contracts and away from the short term two-way exchanges of electricity required to maintain system reliability. (A more detailed discussion is included in the attachment to this statement **UNITED STATES COAL AND CANADA**.)

The level of electricity imports is projected to continue to increase. The Edison Electric Institute has forecast a net peak of 63 billion KWH imports in 1995. Other forecasts, including those of the National Energy Board of Canada, tend to confirm this estimate.

This increase, and the resultant U.S. dependency on imported power is occurring for two reasons. In Canada, utilities, which may have cost advantages available either by virtue of their status as Crown Corporations and/or because of the type of generating capacity available, are being actively encouraged to increase exports. In the United States a ready market for exported electricity is available due to public policy and regulatory practices which discourage U.S. utilities from building facilities necessary to meet their own electricity requirements.

Only the first reason, differences in costs, can be addressed within the framework of the FTA. The second requires action by the Congress and appropriate regulatory agencies at both the Federal and State levels.

Statements have been made that subsidies available to Canadian utilities by virtue of their status as Crown Corporations allow the utilities to compete an a "more than equal" basis with U.S. utilities in providing long term power for U.S. markets. Examples given include freedom from taxation, government assumption of exchange rate risks, initial financing by government and government guarantee of debt.

The FTA did not address the identification and elimination of subsidies which affect free and fair trade. However, both sides did agree that current laws and procedures dealing with subsidies and dumping would be maintained along with the right to bring countervailing or anti-dumping actions against either country. The right to impose duties or tariffs on energy imports (or the imports of any other commodity) should it be proven that either country is subsidizing its industry are also preserved.

Further, Article 1907 of the FTA establishes a working group to "seek to develop more effective rules and disciplines concerning the use of government subsidies; and to seek to develop a substitute system of rules for dealing with unfair pricing and government subsidization."

Language directing the working group, within a time certain, to assess, identify and quantify subsidies available to either U.S. or Canadian utilities and to recommend ways to offset advantages that these subsidies might afford in electricity trade should be included in the implementing legislation.

On the domestic side, Congress must look at U.S. laws and regulation that put U.S. electric utilities and U.S. coal companies at a competitive disadvantage with Canadian utilities. Some U.S. utilities chose to import power rather than build their own generating facilities to meet demands because it is a lower risk option. High costs of construction, made even higher due to the extended time required to site and permit a plant; uncertain and ever changing environmental regulation and standards; and state public utility commission prudence reviews in addition to other factors combine to make utilities reluctant to plan for the future while creating a ready market for imported power.

The Canadians recognize the market advantages to their utilities and their economy by reason of U.S. actions the Canadian government actively encourages export of power. As stated by Marcus Massey, Energy, Mines and Resources Minister in remarks to the Board of the Canadian Electrical Association in Ottawa this past Fall:

> "Canadians are right to try to expand their electricity exports. Why? Several reasons:
>
> --Electricity construction projects create jobs and provide a market for Canadian industrial products;
>
> --Electricity developments lead to new technologies and help us to develop our engineering expertise which can be sold around the world.

> --Electricity exports generate profits and thereby raise national income;
>
> "Electricity exports, especially hydroelectric exports, can also come back to us.
>
> " A hydroelectric facility can last for 100 years, or even longer. Suppose we sign an export contract for 25 years. Then, with the contract in our hand, we build our hydroelectric project. The export revenues will pay for it. Then, when the 25 years are up, the facilities come back to us. For the next 75 years, the electricity is ours to do with as we wish. We can either consume it ourselves or export it again. This is literally a way of turning rain into money. The export market is there. The United States may require as much as 100,000 megawatts of new capacity by the year 2000."

With respect to coal production, there are structural and policy differences between our two countries that result in the U.S. and Canadian coal industries competing on unequal terms. This is in part because the tax structure affecting Canadian mining companies is more favorable.

Canada's federal income tax system has deductions and incentives more liberal than the U.S. Internal Revenue Code. For example, mining companies for Canadian federal tax purposes are permitted to deduct all exploration and development expenses and a depletion allowance of 25 percent of income. A variable investment tax credit is also provided and the current Canadian federal corporate income tax rate is phasing down to 33 percent in 1989. Canada does not have a Black Lung Tax or an Abandoned Mine Lands Fee which collectively total $1.25/ton for underground coal and $0.90/ton for surface coal in the United States.

The FTA recognizes structural differences but does not provide a clear prescription for dealing with these inherent differences in a circumstance where the two economies are to become essentially one unit. From the perspective of the coal industry we cannot suggest that changes be make in Canadian laws. Rather, we believe that some of the disadvantages inherent in our own system should be modified to make the economic unit envisioned in the FTA equitable for all concerned.

With this goal in mind, we would suggest changes to afford U.S. producers more favorable tax treatment similar to that available to the Canadian coal industry. A move toward a more level playing field could be effected initially through legislation to: restore the percentage depletion allowance to the pre-1983 effective rate of 10 percent; removing half the depletion allowance as a preference item for Alternative Minimum Tax purposes as is done for book income; allowing full expensing rather than partial capitalization of exploration and development costs; and crediting coal companies Abandoned Mine Land payments towards the Superfund Excise Tax liability.

A final area of concern which is generic to the underlying rationale for the FTA with respect to energy trade, as well as all trade, is the authority and thus the ability of the Canadian federal government to enforce the provisions of the FTA.

In the United States, the federal government has clear jurisdiction over the states wherever interstate commerce is concerned. In Canada, however, the Canadian federal government does not have the same level of authority over provincial governments. A statement by the Ontario Attorney General, Ian Scott, cites a Privy Council review of a Canadian Supreme Court decision:

> "The Federal Government has the power to make a treaty, the federal government of Canada does not have the power to implement that treaty in areas of provincial jurisdiction."

It can be inferred from this decision that in areas where provincial jurisdiction overrides, the Canadian provinces will not have to abide by the terms and conditions of the FTA. In the United States however, states and industries are bound by the agreement. It would appear that each province would have to ratify the FTA for the same to be true in Canada.

This vitally affects electricity and other energy trade. Provincial governments exercise control over the electric utility industry in two areas: rates, including the review of any potential rate impacts that would occur as a result of proposed export projects; and the development of the electric utility industry within the province to serve both domestic and export customers.

The authority of the Canadian federal government to enforce the terms of this agreement should be clearly delineated before Congress considers implementing legislation. The resolution of these questions could definitely affect the reliability of imported power, or other forms of imported Canadian energy.

This concludes our statement Mr. Chairman. Thank you for your time. We would be pleased to answer any questions.

THE FTA, UNITED STATES COAL AND CANADA

With respect to energy trade the FTA expressly prohibits quantitative restrictions, import or export taxes and minimum export or import prices. The agreement seeks to ensure open market access and requires equitable sharing of energy should shortages occur that would otherwise result in abrogation of an existing supply agreement.

Coal is not specifically addressed as coal trade can and does take place with no restrictions. There are no licenses, tariffs, permits, etc. required in either country for coal exports. The FTA does not address the question of production or transportation subsidies or other favorable treatment that might enhance the competitiveness of either coal industry.

In the **electricity** area, Canada has agreed to eliminate National Energy Board (NEB) requirements that electricity exports must be priced at approximately the cost of the least cost alternative to the U.S. purchaser.[1] Canada has also agreed to implement the "surplus" test on electricity exports "in a manner consistent with the FTA."[2]

The United States' coal industry is in a unique position with respect to trade with Canada. Canada is the single largest foreign customer for our coal, but there is a potential that the coal industry could be effected by the loss of domestic markets due an increase in the importation of electricity on a firm power, or long term contractual, basis. Our thoughts on the Free - Trade Agreement must take both of these factors into account and weigh the advantages of export to a market that could increase with the potential loss of domestic markets.

Canada is the United States' Largest Foreign Coal Customer

In 1987, Canada imported 16.2 million tons of coal from the United States. The next two largest customers, Japan and Italy, took 11 and 9.5 million tons respectively. With very few exceptions, Canada has, for many decades, annually ranked as first on the list of foreign customers for U.S. coal.

The U.S. ships both steam and met coal to Canadian customers, primarily in the eastern provinces. Most of this coal is mined in the Appalachian coal fields. Steam coal goes to Ontario Hydro and cement and industrial plants in Ontario and Quebec. Met coal goes to Algoma Steel Company from West Virginia mines which are owned by the steel company and from other U.S. producers in Appalachia to Canadian steel mills. We expect this trading relationship, which last year contributed almost $700 million towards a favorable balance of payments and provided employment for approximately 5000 miners throughout the Appalachian region, to continue to benefit the U.S. coal industry and the economies of both countries.

If utility companies in the eastern portion of Canada add coal fired capacity, or operate existing coal plants at a greater rate, coal exports could increase.

Imports of Electricity

At the same time, U.S. imports of electricity have the potential to displace domestic coal markets. U.S. utilities have imported Canadian power for decades primarily on an interruptible basis to meet system peaking and seasonal demands. This two- way trade has been, and will continue to be, beneficial to the reliability and operation of utility systems in both the United States and Canada.

Since 1970, however, we have seen roughly a sixfold increase in electricity imports. In 1986, we imported 39 billion kilowatt hours (KWH) from Canada, in 1987, the figure was approximately 47 billion kilowatt hours. U.S. exports of electricity were 4.7 and 3.5 billion KWH in 1986 and 87 respectively. Imports represent only about 2 percent of total electricity produced in the United States, but regional dependencies are significant. For example, in 1986 the latest year for which data is available, the New England states were dependent upon imported power for 9.2 percent of their needs, New York was 12 percent dependent and the North Central states of North and South Dakota, Minnesota, Iowa and Nebraska (the MAPP electricity region), was 7.3 percent dependent on imported power.[3]

The level of imports is projected to increase. The Edison Electric Institute has forecast a net peak of 63 billion KWH imports in 1995. Other forecasts, including those of the National Energy Board of Canada and those of NCA, tend to confirm this estimate. Imports will be to the areas mentioned above: New England, New York and the North Central region. States in the Northwest are also likely to take more power from Canada.

Electricity Trade is now on a Long Term Basis

Although historical trade has been on an exchange, interruptible basis, most of the increase in trade has been, and will be, for firm power imports. This is power under long term contract obligating the utilities to import a guaranteed amount of power and requiring Canadian utilities to supply the power.

These long term arrangements can appear very attractive to a U.S. utility. The United States has, unfortunately, seen a steady increase in barriers to building new, efficient, base-loaded generating capacity and the power lines to effectively tie electric power plants together. Under firm power import arrangements, U.S. utilities can use Canadian imports as a substitute for building new base-loaded power plants. The financial and regulatory uncertainties surrounding new construction have led utilities to turn to Canadian imports which may not require large up front capital investment by the U.S. utility. In the United States there is the very real possibility that state public utility commissions may not allow a return on, or recovery of, investments.

This strategy is not without risk to the U.S. power generation infrastructure as these contracts are merely delaying capacity decisions to some future date. As long term contracts with Canada utilities expire, because these contracts do not equal the life span of a domestic coal-fired power plant, capacity to replace the contracts will be required. Well before that time, the utility will have to (1) begin its own construction program, possibly at costs much higher than current costs, (2) will have to bid for generating capacity from third party producers, or, (3) start renegotiating with the Canadian power producers - if the Canadian utility does not need the power for domestic markets.

Effects of Imports on Domestic Coal Production

National Coal Association is currently completing an update of a July, 1987 analysis of the effects that electricity imports have had on the domestic coal industry. This will be made available to the committee in its entirety when completed. Preliminary results, however, indicate that in 1986 electricity imports displaced some 6.3 million tons of U.S. coal production. Most of the coal displaced was in the North Central region, where about 4.7 million tons of U.S. coal was displaced by imported power, the remainder was displaced coal use in the Northeast.

As electricity imports increase, so does potential coal displacement. Our preliminary analysis, which looks at the next 10 years, indicates that Canadian utilities have the capacity, technological expertise, financing and organization to continue to expand their electricity export markets in all U.S. regions bordering Canada. It is possible, if U.S. utilities do not add utility owned generating capacity or do not purchase domestically generated power from cogenerators or independent power producers, and chose instead to increase power imports, that as much as 24 million tons of domestic coal could be displaced by 1996.

This analysis will be available in its entirety by the end of April, 1988.

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[1] The NEB currently has three pricing tests for proposed exports: (1) the price must be sufficient [illegible] recover all costs (including social costs) incurred in Canada; (2) the price charged cannot be less than the price charged a Canadian utility of customer for equivalent service; and (3) the export price cannot be materially less than the least cost alternative of the U.S. purchaser. The NEB can continue to apply price tests (1) and (2) under the FTA.

[2] The NEB currently subjects applications for exports of firm contract electricity to a surplus test as well as the three price tests. The applicant utility must prove that the power to be exported is "surplus" to national Canadian needs by offering all neighboring provinces the same quantity of electricity at the same price as that planned for export. If those provinces refuse the opportunity to purchase, the export is deemed "surplus."

[3] Source: "Electricity Transactions Across International Borders - 1986", published by the Economic Regulatory Administration, Office of Fuels Programs, U.S. Department of Energy.

John Buckley,
Vice President for Wholesale Marketing,
Cumberland Farms, Inc.

Mr. Chairman and Members of the Committee:

Good afternoon. My name is John Buckley. I am Vice President for Wholesale Marketing of Cumberland Farms, Inc. I appreciate this opportunity to present testimony on behalf of the Citizens for the U.S.-Canada Trade Pact, a coalition of which Cumberland Farms is a member.

I. INTRODUCTION

The Citizens for the U.S.-Canada Trade Pact urge Congress to implement promptly the Canada-U.S. Free Trade Agreement ("FTA"). The FTA constitutes a dramatic reaffirmation of the close political and economic relationship between the two countries.

As its core object, the FTA would eliminate tariffs on bilateral trade. The FTA also addresses a variety of more specific issues, including agricultural trade, trade in services, automotive trade, trade in financial services, energy trade and similar matters. Changes to the customs and international trade laws of both countries will be necessary to accommodate this new relationship. Finally, the FTA creates binational institutions to provide mechanisms for dispute resolution, to administer and interpret the FTA, and to conduct reviews of final determinations under both countries' antidumping and countervailing duty laws.

The FTA energy provisions will benefit both countries by allowing economic, not political, factors to play a greater role in determining energy trade and investment flows between the two countries. The energy provisions will promote an atmosphere of assurance that government intervention will not interfere with sound commercial relationships. They also will stimulate the attainment of natural economic efficiencies in energy trade. Moreover, the FTA will eliminate many of the uncertainties surrounding the investment climate in Canada.

Although its impact in the energy sector should not prove dramatic immediately, the FTA will eliminate the uncertainties about government intervention that impeded the development of otherwise logical economic relationships between the two countries. For these reasons, the Citizens for the U.S.-Canada Trade Pact support the prompt introduction and enactment of implementing legislation for the FTA under Congress' fast-track procedure.

II. INTEREST OF THE CITIZENS FOR THE U.S.-CANADA TRADE PACT

The Citizens for the U.S.-Canada Trade Pact ("CFTP") is an ad hoc coalition of petroleum products marketers who favor implementation of the FTA. Its members are Cumberland Farms, Western Petroleum Company, By-Lo Oil Co., Striker Industries, Mid-States Petroleum and Gull Industries. These companies market refined petroleum products, largely gasoline, along the northern tier of states from Maine to Washington state.

The CFTP emphasizes that its members' support of the FTA is reflective of their long-standing commitment to free trade generally. Members of the CFTP have long been proponents of unrestricted access to offshore supplies of crude oil and refined petroleum products. Even without an actual influx of imports of these products, the mere availability of alternative sources induces efficiencies and price discipline in the U.S. market. Those effects in turn benefit energy consumers. The CFTP's support for the FTA thus is part and parcel of its members' pro-competitive stance.

III. BACKGROUND ON U.S.-CANADA ENERGY TRADE

During the 1950s and 1960s, bilateral energy trade was not subject to the same degree of government intervention as in recent years. Increased imports into the United States, and ultimately the Arab Oil Embargo and its progeny, prompted both governments to intervene heavily in their respective oil markets. This interference not only impeded trade and investment flows, but also created an atmosphere of uncertainty that discouraged the development of long-term commercial and investment relationships. It should be noted that, although outside of the scope of this testimony, there also has been varying and substantial intervention by the two governments in non-oil energy markets.

A. U.S. Import and Export Controls

The United States has long maintained restraints on imports of crude oil and/or refined petroleum products. These restraints have affected imports from Canada to varying degrees.

In 1959, President Eisenhower established the Mandatory Oil Import Program ("MOIP") restraining U.S. imports of crude oil, unfinished oils, and refined petroleum products. But overland imports were exempted from the program. This exemption meant that Canadian oil transported by pipeline or other overland method could be entered into the United States and not be subject to import restraints.

The overland exemption was terminated in 1970, however, with respect to crude oil and unfinished oils. From 1970 to 1973, imports of crude oil and unfinished oils from Canada into regions east of the Rocky Mountains were subject to relatively liberal quotas.

The MOIP was replaced in 1973 by the oil import fee program. Although special treatment was once again afforded Canada, imports from Canada nevertheless were subject to a fee-quota arrangement. Imports of crude oil and unfinished oils could be entered without fee up to a liberal quota amount for Canada alone; imports in excess of the quota were subject to the fee. The quota could be raised if consistent with the purpose of the fee program. Moreover, imports of refined petroleum products from Canada were subject to fees along with refined products imports from all other sources. These restraints on imports were a component of price and allocation controls in the domestic market. The fee program was terminated with respect to all imports in 1980.

U.S. exports of crude oil and refined petroleum products have remained modest since 1959. Indeed, exports of crude oil have been effectively embargoed since the imposition of price and allocation controls in 1973. An exception was allowed for what were essentially barter exchanges with Canada. Since 1985, exports of crude oil from the lower 48 states have been allowed, but only to Canada. Refined products exports have been permitted and have increased significantly since liberalization of the U.S. export licensing program in 1981.

The ability to import and export crude oil and refined petroleum products thus has been subject to frequent and changing U.S. government regulation. Although the United States' special relationship with Canada was recognized consistently in these programs, imports from Canada nevertheless were regulated starting in 1970. The changing and frequent U.S. government intervention injected great uncertainty into the bilateral oil market.

B. Canadian Government Intervention

Before the Arab Oil Embargo in 1973, Canada allowed liberal U.S. access to its oil resources. That event marked a watershed in Canadian oil policies, however. Subsequent Canadian oil policies displayed a much more protective attitude toward its oil resources.

As noted. U.S. import restrictions did not apply to overland imports until 1970. and Canada refrained from restraining its exports until 1973. U.S. imports of crude oil and refined petroleum products from Canada thus grew steadily and dramatically throughout the 1960s. Despite the imposition of U.S. import quotas in 1970. U.S. imports of all crude petroleum and refined petroleum products from Canada continued to grow until 1973. when it reached a peak of nearly 484 million barrels (or an average 1.3 million barrels per calendar day).

In that year. however. Canada reacted dramatically to the world panic engendered by the Arab Oil Embargo. Canada imposed crude oil and refined products export restraints in March 1973. Sharp increases in shipments to the United States preceded this action. Canada further implemented an export tax in September 1973 to make domestic price controls effective. U.S. imports from Canada fell sharply to 170 million barrels in 1978. and fluctuated until they reached a post-1968 low of 163 million barrels (447.000 barrels per calendar day) in 1981.

Between 1973 and 1985. therefore. Canada has had a regulated oil market. The Canadian government controlled prices in Canada. and export restraints continued in the form of a surplus test and export licensing requirements. With the recent oil glut, there has been liberalization and decontrol since 1985. Indeed. U.S. imports of all petroleum products from Canada have increased steadily since 1981 to reach 288 million barrels in 1986 (or an average 789.000 barrels per calendar day).

The Canadian government also interfered significantly in energy investment. During the 1960s. foreign ownership expanded dramatically. Some limited restrictions were adopted (such as the limits on production licenses on federal lands), but serious action was not taken until the 1970s. and then in conjunction with a broader program to limit U.S. involvement. During that decade, the government of Prime Minister Pierre Elliot Trudeau introduced the Foreign Investment Review Act program. This program enabled the Canadian government to screen and, where it deemed appropriate. prohibit the acquisition of Canadian business enterprises. The general program was prompted by a Canadian perception that U.S. investors were increasingly dominating Canadian industry.

These broader concerns were accentuated in the case of oil because of its importance and because of fears that without government intervention Canada would be relegated to the role of a supplier of natural resources to the United States. Petro-

Canada -- a federally-owned corporation -- was created in 1975. and rapidly became Canada's sixth largest producer. The most draconian intervention. however. was effected through the National Energy Program ("NEP") implemented in 1980. The NEP contained a requirement of 50 percent Canadian ownership of the oil and gas industry by 1990. and other Canadianization provisions. U.S. investors immediately began to sell their ownership shares so as to secure the maximum possible value before the forced divestment. This policy has been eased substantially since 1984. however.

C. Consequences of Policies of Government Intervention

There thus has been a history of substantial government intervention in the energy markets of the United States and Canada since 1970. This interference has had two consequences.

First. government intervention has interfered in the operation of the market. Long-term contracts for supply have been discouraged. Indeed. current Canadian regulations require the insertion of a clause in oil export contracts relieving the Canadian exporters of their obligation to export if restricted by the Canadian government. Moreover, U.S. ownership of Canadian energy companies was subject to forced divestment under the NEP. reducing the return received by U.S. investors.

Second. and more importantly. this tradition of government intervention injected considerable uncertainty into the market. Perhaps more significant than the mere presence of government intervention was the frequent change in the intensity and form of government intervention. In a stable. albeit pervasive. regulatory environment. businesses can still enter into long-term relationships because they have confidence in the perpetuation of the current rules of the game. Even though the relationship might be structured differently than without government interference. the relationship nonetheless would develop.

An atmosphere of frequent changes in the rules of the game. however. causes perceptions of greater risk. U.S. importers have been discouraged from relying on Canadian supplies -- despite the fact that they might be the most logical in terms of cost. geography. and similar factors -- because of the very real possibility that future U.S. import restraints or Canadian export restraints would make continued access difficult or impossible. Conversely. a Canadian exporter cannot feel assured about exporting to the U.S. market when Canadian government export restraints or U.S. government import restraints could subsequently deny market access. Nor can a U.S. investor feel secure about an investment which may become subject to new and more rigorous Canadian equity limits. and even divestment requirements.

Government interference in the market, and the consequent uncertainties it created, have prevented the achievement of economic efficiencies possible from close and logical bilateral relationships. The FTA promises to permit, to the extent appropriate, the creation of long-term commercial and investment relationships. These relationships will be dictated by economic factors, not by political circumstances, and thus will benefit consumers in both markets by virtue of enhanced efficiencies and other effects. In many senses, therefore, the FTA constitutes a return to conditions in the bilateral market preceding the tumultuous events in the world energy market of the 1970s.

IV. THE IMPACT OF THE FTA IS TO REMOVE THESE ARTIFICIAL IMPEDIMENTS TO BILATERAL RELATIONSHIPS AND THE ACHIEVEMENT OF ECONOMIC EFFICIENCIES

The FTA will have two basic effects on bilateral trade in the energy sector. First, the FTA will stimulate greater assurance about the government regulatory environment, which will inspire confidence in the creation of commercial and investment relationships as well as help to dampen panic in the event of dramatic disruptions in the world energy market. The FTA also will stimulate the achievement of economic efficiencies that otherwise might be lost because of government intervention in the market. These consequences in turn have favorable implications for both U.S. and Canadian energy security.

A. The FTA Will Stimulate Certainty as a Basis for Bilateral Relationships in the Energy Sector

The FTA will stimulate greater certainty in the business community regarding doing business in Canada or in the United States. The FTA will reduce risks posed by entry into bilateral commercial or investment relationships.

Before turning to the ramifications of this greater certainty, however, "certainty" must first be defined. It means a greater level of confidence that political or nationalist factors will not alter or destroy bilateral relationships. In essence, greater certainty causes the reduction of risk assessments relating to doing business in Canada or the United States. The greater certainty about the future fostered by the FTA also relates to the degree of panic that results from dramatic dislocations in the world energy market; the sense of security engendered by a stable bilateral energy relationship should help to moderate panic in the event of a sharp disruption of supplies from, for example, the Middle East.

1. Commercial Relationships

The FTA will stimulate this greater certainty in three ways. First, it will facilitate the establishment of long-term commercial relationships where dictated by geography and other economic factors. The FTA reaffirms the obligations with respect to energy of both governments under the General Agreement on Tariffs and Trade ("GATT"). This incorporation of GATT into the FTA means that quantitative import restraints may only be imposed in certain, limited circumstances. Moreover, the FTA specifically acknowledges that GATT prohibits minimum-export and minimum-import requirements in all circumstances in which other quantitative restraints are prohibited. These provisions will assure that import restraints are confined to types (and implemented in accordance with procedures) agreed upon by both governments in GATT.

With respect to export measures, the FTA will ensure that supplies are not totally disrupted. An export restraint may not limit Canadian exports to the United States (or vice versa) below the U.S. share of total Canadian supply during a recent representative period. In addition, export restraints may not include government measures that result in a higher price for exports than for domestic sales of the energy product. Finally, the FTA prohibits the incorporation in export restraints of government measures that would disturb normal channels of supply or normal product mixes (for example, the proportion between crude oil and refined products in total exports).

The FTA thus promotes greater certainty in access to supplies. That additional assurance is particularly important when assessing the risks entailed by another oil crisis. The FTA alleviates, with respect to Canada at least, some of the fear that another world oil crisis would bring a repetition of the Canadian export or U.S. import restrictions.

2. Investment Relationships

Second, the FTA will foster the establishment of long-term investment relationships. The FTA will permit investment relationships to be determined more by capital availability, reserves and market conditions than by political factors. Moreover, U.S. investors will not have to hold as great a fear of nationalization, minimum equity restrictions, performance requirements, or the like imposed by a new Canadian government.

The FTA accomplishes this by "locking in" the more liberalized current Canadian investment rules applicable to the energy sector. Under the FTA, Canada may impose energy investment regulations no more restrictive than those in force on October 4, 1987. These regulations have been dubbed the Masse Policy, which embodies a set of rules regarding various aspects of energy investment.

The Masse Policy contains the following major elements:

- Foreign investors will be prevented from directly acquiring a healthy Canadian company in the oil and gas sector.
- Nevertheless, the Canadian government will consider permitting the direct acquisition of a Canadian business that is financially unsound by U.S. investors. If a Canadian oil and gas enterprise is already foreign-owned, the Canadian government will normally permit sale to another foreign investor, albeit perhaps with some generalized commitment to expand Canadian ownership.
- With respect to indirect acquisitions, the Canadian government may insist upon some general commitment to expand Canadian ownership without imposing any specific requirements.
- The Canadian government will continue to require that entities seeking production licenses for Canadian federal lands be 50 percent Canadian owned.

In essence, Canada committed in the FTA to maintaining an investment policy in the energy sector that is no more restrictive than the Masse Policy.

The Masse Policy obviously perpetuates some obstacles to U.S. investment in the Canadian energy sector. By mandating that the Masse Policy is the maximum degree of government intervention, however, the FTA provides substantially greater certainty for potential U.S. investors. Canadian energy investment policies have fluctuated, but displayed a general movement toward greater "Canadianization" in ownership regulations since the 1960s. This trend culminated with the NEP's requirement of 50 percent Canadian ownership by 1990, and the associated buyout of U.S. energy investments by Canadian investors. This program abated somewhat with the advent of the Masse Policy. The FTA minimizes the risk of a repetition of this evolution and thus provides greater clarity for U.S. investors. This greater assurance -- that the investment climate in Canada will remain stable for the foreseeable future -- is a positive development despite the retention of substantial Canadian government regulation of investment in the energy sector.

3. Effects in the Event of Market Disruption

Finally, the assurances provided by the FTA will help to assuage, albeit not eliminate, the panic that normally follows dislocations in the international energy market. It is this panic, rather than actual physical supply shortages, that has tended to cause rapid oil price increases.

In the future, the United States will inevitably be reliant to some degree on foreign oil supplies. This reliance need not amount to vulnerability, however. If events in a politically unstable region like the Middle East disrupt oil supplies, the assurance of access to Canadian supplies embodied in the FTA will help to dampen the panic. As noted above, there will be less chance of a repetition of the Canadian government export restraints that followed the Arab Oil Embargo in 1973. The FTA provisions, moreover, signify to the market that not all foreign sources of crude oil and petroleum products are susceptible to political interference, and that the impact of a disruption in supply should be evaluated in its specific regional context rather than immediately assumed global in scope.

B. The FTA Will Stimulate the Achievement of Economic Efficiencies in Bilateral Energy Trade

The FTA also will stimulate the attainment of economic efficiencies in bilateral energy trade. The history of government intervention related above has hindered or prevented the achievement of such efficiencies. Although they will not be dramatic in magnitude, there are clear economic complementarities that can be developed, if only by virtue of the elimination of tariffs or geography. Moreover, long-term investment relationships are made more possible by the FTA, thereby enhancing the likelihood of the long-term development of high cost Canadian reserves.

1. Elimination of Tariffs

The clearest complementarity of the FTA will be the benefit provided consumers through the elimination of tariffs. U.S. tariffs on crude oil and petroleum products are significant; their elimination will yield substantial benefits for U.S. consumers, especially along the northern tier.

Current U.S. tariffs on crude oil equal either 5.25 cents per barrel or 10.5 cents per barrel, depending upon the oil's specific gravity. For petroleum products, U.S. tariffs range from 5.25 cents per barrel on distillate and residual fuel oils (with a specific gravity under 25 degrees API) to 52.5 cents per barrel on motor fuel and 84 cents per barrel on lubricating oils. Imports of kerosene and naphthas, except those qualifying as motor fuel, are assessed a duty of 10.5 cents per barrel.

U.S. imports of these products from Canada are substantial and growing. U.S. imports of crude oil and shale oil from Canada, for example, increased from 175 million barrels in 1985 to 209 million barrels in 1986. Moreover, Canada is one of the most significant sources of U.S. crude oil imports, accounting for more than 12 percent of total crude oil imports in each year since 1985. Canada placed within the top three sources of U.S. crude oil imports during that period. A similar situation exists with respect to petroleum products. Canada has been a leading source of U.S. imports of motor fuels and lubricating oils, among other items.

The elimination of tariffs on these imports will provide substantial savings to U.S. consumers. This benefit of the FTA can be illustrated by using 1986 as an example. In that year, U.S. consumers paid $17.8 million in regular customs duties on imports of crude oil from Canada, and another $6.9 million in duties on imports of Canadian gasoline. These costs were concentrated disproportionately among consumers along the northern tier of states. During the period January-October 1987, for instance, only 2.3 percent of Canadian crude oil and 11.0 percent of Canadian gasoline was imported through ports outside of the northern tier. Nor are these imports distributed widely once entered; generally, they are refined and/or marketed regionally where imported.

The elimination of tariffs on imports of Canadian crude oil and petroleum products thus will mean substantial savings for consumers of these products, especially in the northern United States. This is the clearest and most direct, but by no means the sole, benefit of the FTA energy provisions.

2. Commercial Relationships

Simple geography dictates that there are many complementarities along the northern tier of the United States. Regional situations in both countries -- such as location of transportation facilities, location of refineries and terminals, location of pipelines, local competitive circumstances and the like -- inevitably will lead to complementary relationships along the borders. Some clear potential examples include:

- Canadian Crude Oil and Northern Tier Refineries

  There are existing relationships between U.S. refineries in the Midwest and Canadian crude oil exporters. A major pipeline runs from Edmonton, Alberta through Minnesota, Wisconsin, Illinois, Indiana and Michigan before returning to Canada near Windsor, Ontario. Refineries located near St. Paul and Chicago have long obtained crude oil supplies through this pipeline. In the period January-October 1987, for example, more than 69 percent of total U.S. crude oil imports from Canada entered through Minnesota or Illinois customs districts. The FTA will provide greater assurance that those supplies will remain secure. Moreover, the U.S. Midwest contains asphalt refineries and refineries capable processing heavier grades of crude oil. These refineries can complement

Canadian producers of heavy oil and tar sands as those higher cost resources are exploited in the future.

- Alaskan North Slope Crude Oil and Western Canadian Refineries

  An opposite complementarity might exist along the U.S. West Coast. Crude oil extracted from Alaskan North Slope ("ANS") fields has engendered an oil surplus west of the Rocky Mountains in the United States. There are no U.S. pipelines available to transport this oil to the more needy Eastern regions. U.S. law, moreover, generally prevents the exportation of this oil, even to refineries located just across the border in Vancouver. British Columbia. The FTA would allow the export of a limited quantity (50,000 barrels per day on average) of ANS crude oil to these refineries. Moreover, the requirements of the Jones Act will still be respected by the FTA. Under the FTA, the ANS crude oil must be shipped by tanker to Washington state before being transported by pipeline to Vancouver. In turn, gradually diminishing supplies of Canadian light crude oil can be redirected East to Canadian and U.S. refineries serving the Midwest and Atlantic regions. Both countries thus can benefit by a more efficient and secure regional allocation of crude oil supplies.

- Canadian Energy Supplies Serving New England

  The scarcity of various energy resources in New England is well known. The FTA will provide a more favorable atmosphere for the establishment of long-term complementary relationships in the energy sector to ameliorate these problems. Canadian refineries located in Newfoundland and Nova Scotia can serve New England refined products markets. In the period January-October 1987. for example. 4.1 million barrels of Canadian gasoline entered the United States through New England customs districts. These imports represented more than 46 percent of total U.S. gasoline imports from Canada. Under the FTA. the Canadian refineries can be more assured that those markets will remain open while U.S. consumers can be more assured that those supplies will remain available. The same effects would hold true in the realm of hydroelectric energy. where Quebec has expressed an interest in exporting more electricity into New York and New England.

- Transportation of Beaufort Sea Crude Oil through the Trans-Alaska Pipeline

  A more speculative, long-term complementarity might be cooperation in the development and transportation of remote Arctic reserves. For example, the Trans-Alaska Pipeline could be used to transport crude oil production from remote northern Canada. Canada appears to have substantial reserves in the Beaufort Sea-Mackenzie River Delta region along its northern coast. These reserves. however. are located in a harsh environment and are very costly to develop and produce. In the event that the world price of oil rises to a substantially higher level. these reserves may become more justified economically. A logical complementarity therefore would be to avoid the enormous expense and ecological risk of constructing a new pipeline when the crude oil could be transported through the existing Trans-Alaska Pipeline. Other. similar complementarities in these remote northern regions also can be envisioned.

3. Investment Relationships

The FTA also could stimulate the achievement of efficiencies in the area of investment and even the sharing of technology. These benefits appear more speculative because of current conditions in the world energy market. Nevertheless, the FTA will provide a stable foundation for the mutually beneficial development of petroleum reserves when justified by conditions in the world market.

Both the United States and Canada possess substantial oil reserves that are extremely expensive to exploit. Colorado and Wyoming in the United States, and Alberta and Saskatchewan in Canada, contain large reserves of tar sands and/or heavy oil. Moreover, Canada has potentially large reserves in the Beaufort Sea/Mackenzie River Delta region and offshore along its Atlantic coast. All of these reserves are extremely costly to explore, develop and produce. The tar sands/heavy oil require special processing to convert into synthetic fuels to be used commercially. Although apparently comprised of lighter grades of crude oil, the Arctic and offshore reserves are in remote, harsh environments. Indeed, certain reserves may not yet be recoverable because of the need for more advanced technology before commercial operations could commence.

The development of these reserves cannot be justified economically under present market conditions. The world oil price is simply not high enough to stimulate investment, exploration or development. The artificial stimulation of such development would not benefit either country because it would require protected markets in which the price of oil would be considerably higher than the international price. Such a differential would undermine the competitiveness of energy-consuming industries in both countries.

If and when the world oil price does reach appropriate levels, however, the FTA will further stimulate the exploitation of these high cost reserves in two ways. First, it will provide a larger assured market over which to spread development and production costs. The oil produced from these reserves will flow to its natural markets, rather than to markets circumscribed by political factors.

In addition, the FTA will provide a stable investment climate. Such stability will be important given the large amount of capital needed. Under the FTA, a larger pool of capital will be available from which to draw for the exploitation of these high cost resources.

Finally, technology flows may be enhanced by the FTA. The more remote reserves, as noted, will require advanced technology to be made commercially feasible. Synthetic fuel production, deepwater operations, and harsh Arctic environment operations all will benefit by a sharing of experience and technology between the national oil industries. The greater atmosphere of assurance fostered by the FTA will facilitate the sharing of this technology. The FTA will dampen fears, for example, that technology shared will later be nationalized and used against the provider. The long-term relationships permitted by the FTA, and the greater confidence it inspires, will provide a solid basis for the necessary cooperation.

Various economic efficiencies thus will be promoted by the FTA. The least cost alternative for crude oil and refined products will prevail along border regions, stimulating competition and benefitting consumers. The FTA also will engender price discipline simply by virtue of the availability of assured alternate sources of supply. The mere availability of crude oil and refined products from Canada, in other words, will provide an incentive for U.S. producers to engage in competitive pricing. Finally, the FTA may accelerate the rate at which high cost reserves are brought into production, when otherwise justified by world market conditions, because the FTA will provide a larger assured market for production and a more favorable investment climate.

C. Implications for Energy Security

The FTA will have beneficial implications for energy security for both countries. Although the FTA will not provide immunity from world market conditions, it will render both countries better able to withstand the political exploitation of energy resources or sharp disruptions of supply.

The FTA will provide the foundation for the complementary, efficient and sound operation of the U.S. and Canadian energy markets. Such markets should prove more resilient and more secure in a volatile world energy market. The assurance of Canadian supplies, for example, should dampen the panic that often follows interruptions in the flow of Middle Eastern supplies.

Finally, both countries will benefit by the greater political and economic flexibility permitted by resilient energy markets. The actual and perceived vulnerability of the United States to Middle Eastern sources of supply, for example, will be reduced by the assurance of supplies from Canada. The United States accordingly will be better able to select policy options that will lead to long-term stability in the region as opposed to policy options that might expediently assure continued flow of petroleum supplies in the short run.

V. CONCLUSION

The FTA should not be expected to cause dramatic changes in the U.S. and Canadian oil markets. Rather, it should be viewed as an exercise in foundation-building. The FTA will place bilateral oil trade on a sound footing by permitting economic, rather than political, factors to play a greater role in determining bilateral trade in crude oil and refined petroleum products as well as bilateral investment flows. In many ways, the FTA constitutes a restoration of the more rational bilateral energy policies of the 1950s and 1960s. The Citizen for the U.S.-Canada Trade Pact therefore believe that the FTA is in the best interests of the United States as well as Canada, and urge its prompt implementation.

Thank you for your kind attention. I will be pleased to answer any of the Committee's questions at this time.

TESTIMONY
OF
NICHOLAS J. BUSH
PRESIDENT
NATURAL GAS SUPPLY ASSOCIATION

GOOD MORNING MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE. I AM NICHOLAS J. BUSH, PRESIDENT OF THE NATURAL GAS SUPPLY ASSOCIATION -- A NATIONAL ORGANIZATION COMPRISED OF INDEPENDENT AND INTEGRATED DOMESTIC PRODUCING COMPANIES WHICH MARKET ROUGHLY 90 PERCENT OF THE NATION'S NATURAL GAS PRODUCTION.

MR. CHAIRMAN, WE APPRECIATE THIS OPPORTUNITY TO COMMENT ON THE PENDING U.S.-CANADA FREE TRADE AGREEMENT (F-T-A) AND, IN PARTICULAR, ON ITS POTENTIAL IMPACT UPON DOMESTIC GAS PRODUCERS AND U.S. GAS MARKETS.

THE FREE TRADE AGREEMENT'S STATED ENERGY GOAL IS TO "ASSURE THE FREEST POSSIBLE BILATERAL TRADE IN ENERGY, INCLUDING NONDISCRIMINATORY ACCESS FOR THE U.S. TO CANADIAN ENERGY SUPPLIES AND SECURE MARKET ACCESS FOR CANADIAN ENERGY EXPORTS TO THE U.S."

THE NATURAL GAS SUPPLY ASSOCIATION (N-G-S-A) WHOLEHEARTEDLY ENDORSES FREE, EQUAL AND OPEN ENERGY TRADE BETWEEN THE UNITED STATES AND CANADA. AND WE DO SO FOR REASONS WHICH EXTEND BEYOND A SINCERE COMMITMENT TO THE PRINCIPLES OF FREE MARKETS AND FREE TRADE. DOMESTIC GAS PRODUCERS BENEFIT WHEN THERE IS A FLOURISHING MARKET FOR THEIR PRODUCT. EXPERIENCE HAS SHOWN THAT SUCH A MARKET RESULTS FROM STRONG CONSUMER CONFIDENCE. IT IS IMMENSELY BENEFICIAL TO ALL SEGMENTS OF THE NATURAL GAS INDUSTRY WHEN END-USERS ARE CONFIDENT THAT THE PROSPECTS FOR ACQUIRING

FUTURE SUPPLIES TO MEET REASONABLE DEMAND EXPECTATIONS ARE GOOD AND THAT CONSUMERS WILL BE ABLE TO COMPETE FOR ACCESS TO ALL COMPETITIVELY PRICED SUPPLIES THAT CAN SERVE THEIR MARKETS.

MOST ENERGY FORECASTS CONCLUDE THAT COMPETITIVELY PRICED IMPORTS OF CANADIAN NATURAL GAS MAY MAKE AN IMPORTANT CONTRIBUTION TO MEETING FUTURE U.S. ENERGY NEEDS. THUS, TO THE EXTENT THAT THE F-T-A REASSURES U.S. CONSUMERS THAT FUTURE NATURAL GAS SUPPLIES FROM CANADA WILL NOT BE UNFAIRLY RESTRICTED OR UNREASONABLY PRICED, THE AGREEMENT MAY CONTRIBUTE TO MORE STABLE LONG-TERM U.S. GAS DEMAND AND TO A LARGER NATURAL GAS MARKET THAN WOULD OTHERWISE EXIST, ABSENT SUCH ASSURANCES. AND DOMESTIC GAS PRODUCERS WANT TO COMPETE IN A GROWING GAS MARKET.

MEMBERS OF THE COMMITTEE ARE AWARE, HOWEVER, THAT NGSA AND OTHER PRODUCER ASSOCIATIONS HAVE EXPRESSED CONCERNS ABOUT THE ABILITY OF DOMESTIC GAS PRODUCERS TO FREELY COMPETE WITH THEIR CANADIAN COUNTERPARTS. SOME CANADIANS SAY THESE CONCERNS WITH BEING ABLE TO COMPETE "FAIRLY" OR -- TO USE THE CLICHE -- "ON A LEVEL PLAYING FIELD" ARE ACTUALLY THE WOLF OF PROTECTIONISM TRYING TO DRESS ITSELF IN THE INNOCUOUS COVER OF SHEEP'S CLOTHING. NOTHING COULD BE FURTHER FROM THE TRUTH.

THE WILLINGNESS OF DOMESTIC PRODUCERS TO COMPETE WITH OUR CANADIAN COUNTERPARTS FOR U.S. MARKETS IS SINCERE. BUT IT WOULD BE IRRESPONSIBLE TO LEAVE THIS COMMITTEE OR THE CONGRESS WITH THE IMPRESSION THAT WHEN THE FREE TRADE AGREEMENT IS ADOPTED, U.S. PRODUCERS WILL NECESSARILY BE ABLE TO COMPETE ON AN EQUAL FOOTING

WITH THEIR CANADIAN COUNTERPARTS. EQUAL FOOTING DEPENDS ON WHETHER THE U.S. GOVERNMENT IS WILLING TO TAKE SPECIFIC ACTIONS THAT WOULD ALLOW DOMESTIC PRODUCERS TO TAKE ADVANTAGE OF NEW EXPLORATION, PRODUCTION AND MARKETING OPPORTUNITIES.

U.S OIL AND GAS DEVELOPMENT, AND AS A RESULT DOMESTIC PRODUCERS, ARE STILL RESTRICTED BY SEVERAL IMPORTANT GOVERNMENT POLICIES WHICH MUST BE CHANGED IF THE NATION IS TO BENEFIT FROM ITS REMAINING SIGNIFICANT ENERGY RESOURCE POTENTIAL.

CANADA HAS RESPONDED TO CHANGING ENERGY MARKET REALITIES MORE COMPLETELY THAN HAS THE U.S. NATURAL GAS IS TOTALLY DEREGULATED AT THE WELLHEAD IN CANADA, WHILE CERTAIN PRICE AND NON-PRICE CONTROLS ARE STILL IN EFFECT ON NATURAL GAS AT THE WELLHEAD IN THE UNITED STATES.

STATEMENTS SOMETIMES ARE MADE THAT THE CURRENT HIGHLY COMPETITIVE U.S. WELLHEAD MARKET FOR NATURAL GAS HAS MADE TOTAL DEREGULATION LESS IMPORTANT. WE DO NOT AGREE. TOTAL WELLHEAD DEREGULATION OF NATURAL GAS WILL RESULT IN THE EVENTUAL DEVELOPMENT OF SIGNIFICANTLY MORE DOMESTIC RESERVES, REDUCTION IN THE USE OF IMPORTED OIL, AND A LESSENING OF THE TRADE DEFICIT. TOTAL DEREGULATION OF NATURAL GAS AT THE WELLHEAD WOULD ENHANCE DOMESTIC PRODUCERS' LONG-TERM ABILITY TO COMPETE WITH CANADIANS.

AS IMPORTANT, THERE ARE SEVERAL ISSUES BEFORE THE FEDERAL ENERGY REGULATORY COMMISSION WHICH MAY DETERMINE THE COMPETITIVENESS OF DOMESTIC GAS PRODUCERS. THE COMMISSION IS

CURRENTLY CONSIDERING A FINAL RULEMAKING ON OPEN-ACCESS TRANSPORTATION OF NATURAL GAS ON INTERSTATE PIPELINES. ACHIEVING A NON-DISCRIMINATORY, OPEN-ACCESS NATIONAL TRANSPORTATION SYSTEM IS VERY IMPORTANT FOR NATURAL GAS PRODUCERS AND CONSUMERS AND NGSA HAS STRONGLY SUPPORTED FERC'S EFFORTS IN THIS REGARD.

THE COMMISSION'S INTERIM TRANSPORTATION RULE, ORDER NO. 500, HOWEVER, CONTAINS AN EXTREMELY DAMAGING REQUIREMENT CALLED CROSS-CONTRACT CREDITING WHICH, IF INCORPORATED IN THE FINAL RULE, WILL HAVE A NEGATIVE IMPACT ON DOMESTIC GAS DEVELOPMENT AND WILL PLACE DOMESTIC PRODUCERS AT A DISADVANTAGE IN COMPETING WITH CANADIAN GAS TO WHICH THE CONTRACT ABROGATION PROVISIONS OF ORDER NO. 500 WILL NOT APPLY.

APPENDED TO MY TESTIMONY, MR. CHAIRMAN, ARE NGSA'S MOST RECENT SUBMISSIONS TO THE COMMISSION ON ORDER NO. 500. I WOULD RESPECTFULLY ASK THE COMMITTEE TO REVIEW THE PROBLEMS CROSS-CONTRACT CREDITING WILL MEAN TO DOMESTIC PRODUCERS. AS MEMBERS OF THE COMMITTEE MUST KNOW THERE IS CONSIDERABLE CONTROVERSY IN THE NATURAL GAS INDUSTRY OVER THE RECOVERY OF SIGNIFICANT CONTRACT REFORMATION COSTS -- USUALLY REFERRED TO AS THE PASSTHROUGH OF BUY-DOWN AND BUY-OUT COSTS FOR TAKE-OR-PAY LIABILITIES.

THE FEDERAL ENERGY REGULATORY COMMISSION, AS A GENERAL RULE, IS NOT ALLOWING THE RECOVERY OF TAKE-OR-PAY SETTLEMENT COSTS IN PIPELINE DEMAND CHARGES. BUT TAKE-OR-PAY SETTLEMENT COSTS ASSOCIATED WITH CANADIAN CONTRACTS HAVE BEEN PERMITTED BY FERC TO

BE PLACED IN PIPELINE DEMAND CHARGES. IN AN ENVIRONMENT IN WHICH NATURAL GAS SALES ARE WON AND LOST BECAUSE OF A FEW PENNIES DIFFERENCE, THIS INCONSISTENT POLICY IS NOT UNIMPORTANT. IF DOMESTIC GAS IS TO BE FULLY COMPETITIVE, A POLICY THAT TREATS SETTLEMENT COSTS EQUALLY IS NEEDED.

IN THIS CONTEXT, WE HEARTILY ENDORSE THE PROPOSALS OF OUR GOOD FRIENDS IN THE INTERSTATE PIPELINE AND LOCAL DISTRIBUTION COMPANY SECTORS OF THE INDUSTRY WHICH ASK FEDERAL REGULATORS TO RESPECT THE SANCTITY OF LONG-TERM CONTRACTS WITH CANADIAN PRODUCERS. I NOTE, HOWEVER, THE IRONY OF THIS SUPPORT FOR CANADIAN PRODUCER AGREEMENTS AT THE SAME TIME THAT PIPELINES AND DISTRIBUTORS ARE ENGAGED IN AN UNRELENTING, INTENSE CAMPAIGN TO OVERTURN DOMESTIC PRODUCER CONTRACTS.

THE COMMITTEE MAY BE FAMILIAR WITH FREQUENT REFERENCES BY THE DOMESTIC PRODUCING INDUSTRY TO THE IMPORTANCE OF FERC'S OPINION NO. 256. SIMPLY STATED, OPINION NO. 256 DECREED THAT U.S. INTERSTATE PIPELINES COULD NO LONGER PASSTHROUGH CERTAIN COSTS OF CANADIAN GAS IN THE DEMAND CHARGE OF THEIR RATE STRUCTURE FOR WHICH SIMILAR COSTS OF U.S. GAS WERE NOT ALLOWED TO BE PASSED-THROUGH IN THE SAME MANNER. OPINION NO. 256 IS VERY SIGNIFICANT TO DOMESTIC PRODUCERS WHO TRY TO COMPETE AGAINST CANADIAN GAS, PARTICULARLY IN THE CRITICAL CALIFORNIA MARKET. FOR YEARS, DOMESTIC PRODUCERS IN THE SOUTHWEST WHO SERVE THE EL PASO AND THE TRANSWESTERN PIPELINE SYSTEMS INTO CALIFORNIA, AS WELL AS CALIFORNIA PRODUCERS SERVING THEIR OWN MARKETS, HAVE COMPETED AGAINST CANADIAN GAS WHICH, BY TAKING ADVANTAGE OF

UNEQUAL RATE STRUCTURE TREATMENT, HAD SIGNIFICANT PRICE ADVANTAGES.

THE FREE TRADE AGREEMENT WILL NOT REVERSE OPINION NO. 256, BUT THE FTA WILL PERMIT CANADA TO CHALLENGE THE OPINION UNDER THE BINATIONAL CONSULTATION AND DISPUTE RESOLUTION PROCEDURE. WE WOULD ASSUME THAT THE CANADIAN GOVERNMENT WILL DO SO -- GIVEN ITS STRONG OBJECTION TO THE OPINION AND ITS APPARENT WILLINGNESS TO FIGHT FOR THE INTERESTS OF ITS PRODUCERS AND GAS PRODUCTION. THE FEDERAL ENERGY REGULATORY COMMISSION HAS NOT YET IMPLEMENTED OPINION NO. 256 ON IMPORTED GAS. MOREOVER, IT APPEARS THAT THE BINATIONAL DISPUTE RESOLUTION PROCEDURE ASSUMES THAT A PANEL WILL BE CONVENED OF PARTIES FROM BOTH NATIONS TO REVIEW THE ISSUE UNDER DISPUTE AND CONCEIVABLY THE PANEL WOULD HAVE THE POWER TO OVERRIDE THE DECISION OF EITHER COUNTRY'S REGULATORY AUTHORITY.

GIVEN THE IMPORTANCE OF OPINION NO. 256, WE WOULD STRONGLY URGE THE CONGRESS TO MAKE IT CLEAR THAT OPINION NO. 256 MAY NOT BE OVERTURNED AND THAT IT SHOULD BE APPLIED ACROSS THE BOARD BY ALL APPROPRIATE U.S. REGULATORY ENTITIES. AS IMPORTANT, THE CONGRESS SHOULD WEIGH CAREFULLY THE IMPLICATIONS OF THIS EXTREMELY POWERFUL F-T-A RESOLUTION PROCEDURE, PARTICULARLY WITH RESPECT TO ENERGY MATTERS.

THE ISSUES OF CANADIAN TAX POLICIES VERSUS U.S. TAX POLICIES AS THEY RELATE TO ENERGY PRODUCTION ARE SOMEWHAT CONTROVERSIAL. THE DEPARTMENT OF ENERGY IN ITS RECENT REPORT STATES THAT "CANADIAN AND U.S. TAX AND FISCAL SYSTEMS DIFFER IN SO MANY

SIGNIFICANT RESPECTS THAT EXACT COMPARISON IS DIFFICULT AND POTENTIALLY MISLEADING." PERHAPS, BUT IT DOESN'T MAKE SENSE TO IGNORE THE RESULTS OF DETRIMENTAL U.S. TAX AND FISCAL POLICIES.

CANADA DOES NOT HAVE A "WINDFALL PROFITS" TAX ON OIL AND NEITHER SHOULD THE UNITED STATES. THE "WINDFALL PROFITS" TAX WHICH ADVERSELY IMPACTS THE EXPLORATION FOR OIL AND INDIRECTLY FOR GAS SHOULD BE REPEALED IN THIS SESSION OF CONGRESS.

THERE ARE, OF COURSE, OTHER TAX AND ROYALTY DIFFERENCES BETWEEN THE U.S. AND CANADA WITH RESPECT TO ENERGY. THERE IS A PROVISION IN CANADA THAT PERMITS ROYALTY "HOLIDAYS" FOR CERTAIN PRODUCTION FROM EXPLORATORY WELLS DRILLED BETWEEN OCTOBER, 1986 AND NOVEMBER, 1989 TO DEPTHS BELOW 8,000 FEET. THIS ENCOURAGES EXPLORATION FOR GAS IN CANADA. FURTHER, CANADA ALSO PROVIDES FOR FULL CURRENT TAX DEDUCTION FOR EXPLORATION COSTS. AS YOU SENATOR BENTSEN, SENATOR DOMENICI AND OTHERS HAVE NOTED FREQUENTLY, THE TOTAL ROYALTY AND TAX BURDEN ON U.S. ENERGY PRODUCTION IS SIGNIFICANT AND ITS IMPACT ON DOMESTIC PRODUCERS CAN BE SEVERE. AFTER THE TRADE AGREEMENT IS ENACTED, THE CONGRESS SHOULD REVIEW THE APPROPRIATE TAX AND RELATED LAWS WITH AN EYE TO ENCOURAGING DOMESTIC EXPLORATION AND DEVELOPMENT.

FINALLY, THE U.S.-CANADA FREE TRADE AGREEMENT DEBATE HIGHLIGHTS THE NECESSITY OF ADDRESSING U.S. POLICIES ON RESPONSIBLE ENERGY DEVELOPMENT ON ITS PUBLIC LANDS. THE U.S. PETROLEUM INDUSTRY HAS AN OUTSTANDING ENVIRONMENTAL RECORD. THE POTENTIALLY ENERGY RICH LANDS OF ANWR AND OFFSHORE CALIFORNIA SHOULD BE OPENED FOR RESPONSIBLE EXPLORATION AND DEVELOPMENT.

MR. CHAIRMAN, THE PENDING U.S.-CANADA FREE TRADE AGREEMENT, WHEN ADOPTED, IS LIKELY TO HAVE LITTLE IMMEDIATE IMPACT ON DOMESTIC GAS MARKETS. LONGER-TERM, THE IMPACT OF THE AGREEMENT IS LIKELY TO DEPEND UPON THE ACTUAL ENERGY POLICIES WHICH ARE ADOPTED BY THE RESPECTIVE NATIONS.

AFTER THE AGREEMENT IS ENACTED, IF U.S. GAS PRODUCTION REMAINS BURDENED WITH LEGISLATIVE AND REGULATORY DISINCENTIVES AND CONTROLS, THEN U.S. PRODUCERS WILL UNDOUBTEDLY LOSE MARKET SHARE AND THE DOMESTIC ECONOMY WILL SUFFER. THE WAY TO PREVENT THIS AND TO ASSURE THE BENEFICIAL ELEMENTS OF FREE AND OPEN TRADE IS TO MAKE U.S. ENERGY POLICY MORE RESPONSIVE AND MORE CONDUCIVE TO DOMESTIC ENERGY DEVELOPMENT.

THANK YOU FOR THIS OPPORTUNITY TO PRESENT THE VIEWS OF THE NATURAL GAS SUPPLY ASSOCIATION.

UNITED STATES OF AMERICA
BEFORE THE
FEDERAL ENERGY REGULATORY COMMISSION

Regulation of Natural Gas) Docket Nos. RM87-34-000,
Pipelines After Partial) *et al.* (Order Nos. 500,
Wellhead Decontrol) *et seq.*)

COMMENTS OF THE NATURAL GAS SUPPLY ASSOCIATION

Pursuant to the Commission's Notice of Public Hearing issued in the above styled and docketed proceeding on March 8, 1988, the Natural Gas Supply Association ("NGSA") respectfully submits the following comments:

NGSA SUPPORTS THE PRO-COMPETITIVE EFFORTS OF THE COMMISSION AS EXPRESSED IN ORDER NO. 436

NGSA strongly supported the non-discriminatory carriage principles of Order No. 436, and continues to favor open-access transportation by interstate pipelines which, when coupled with other Commission initiatives, has provided a means whereby consumers can truly obtain supplies of natural gas at the lowest reasonable rate. The natural gas pipeline system provides the means whereby supplies of natural gas available in the producing areas can reach the consumer. Inasmuch as the pipelines provide the only feasible means of getting natural gas from the producer to the consumer, the Commission should, by its lawful regulation of the interstate natural gas pipeline industry, take the necessary steps to ensure that the pipelines which it regulates in fact provide non-discriminatory transportation to those who request it. Only through this means can the Commission assure that the consumer will receive the benefits of a competitively priced fuel.

THE COMMISSION SHOULD RECOGNIZE THE SUBSTANTIAL PROGRESS THAT HAS BEEN MADE IN RESOLVING TAKE-OR-PAY WITHOUT GOVERNMENT INTERFERENCE

The Commission should, in fashioning a final rule in these proceedings, recognize the substantial progress that has been made by pipelines and producers in resolving the take-or-pay liability of the pipelines. This progress has come about through the inexorable forces of the market at work. It has resulted in the resolution of 84% of pipelines' claimed outstanding liability through 1987 (see Appendix A). The cost of this resolution has been enormous to the producers. Pipelines, too, have borne costs in reforming these contracts, entered into solely for the purpose of standing ready to serve the actual and projected needs of their customers. LDCs, however, have borne little of these costs for lack of realistic cost passthrough. But to hear the pipelines and their customers tell the story, the producers should give up even more. They ignore the facts that the producers have spent billions of dollars to explore for and develop the very gas they said they needed. And these billions were invested by producers in the expectation that the pipelines and their customers would purchase the gas pursuant to the contracts the producers had with the pipelines. As the market determined that the prices were too high, the producers and the pipelines set about to find a satisfactory solution to the problem of high-priced gas. PRODUCERS GENERALLY GAVE UP THE BENEFITS OF THEIR CONTRACTS FOR NON-PRICE CONCESSIONS, AND A PRICE REDUCTION FOR FUTURE PRODUCTION THAT WOULD ALLOW THE PIPELINES TO CONTINUE AS A MERCHANT OF GAS. WHERE CASH PAYMENTS WERE

MADE TO PRODUCERS, THE AMOUNT RECEIVED BY THE PRODUCERS HAS BEEN ONLY A FRACTION OF THE LIABILITY THAT THE PIPELINES OWED. These costs to producers are very real.

THE COMMISSION SHOULD DISAVOW BLANKET CREDITING AS A MEANS FOR "RESOLVING" THE TAKE-OR-PAY PROBLEM

Nowhere has the Commission done more harm to the producing industry in recent years than in its misguided attempt to resolve the pipelines' take-or-pay dilemma through the crediting mechanism propounded by Order Nos. 500, et seq. The Order No. 500 crediting mechanism is at odds with the principles of non-discriminatory open-access transportation. Crediting undermines the objectives of encouraging a freer, more competitive city gate market for natural gas. Crediting impedes open-access because it is a condition to access, a condition that many producers cannot economically afford to satisfy. In practice, many producers will not offer open-ended blanket credits to pipelines since they are unable to determine the economic effects such offers may have on their existing and future operations. Customers of pipeline companies with large outstanding take-or-pay obligations are being deprived of competitively-priced natural gas which could be transported and delivered to them if the Order No. 500 crediting mechanism were not in effect.

The Commission's Order No. 500 crediting mechanism has forced pipelines and producers that have freely negotiated resolution of their problems back into the adversarial ring once more. Those settlements, resolving as they did the pipelines' past take-or-pay liabilities and reforming as they did many of the contracts, often resulting in the release of gas for producers to sell on the open market in competition with pipelines, with other sellers of gas and with alternate fuels, have now been turned on their sides, with additional consideration now being demanded of producers in the form of take-or-pay credits when gas is moved on the very pipeline with which the producer thought it had reached settlement on fair and equitable terms. NGSA submits that the Commission should not by regulatory fiat permit this to occur. Yet this is the very result that blanket crediting has had. The Commission should provide in its final rule that any gas subject to take-or-pay relief or subject to a contract which has been renegotiated as a part of a settlement of pricing or take-or-pay disputes should be permanently exempt from crediting by the settling pipeline or any other pipeline transporter.

CREDITING, IF IT IS TO BE RETAINED AT ALL, SHOULD BE SELECTIVE IN A MANNER SIMILAR TO THAT PROVIDED BY THE COMMISSION IN ORDER NOS. 500-C & 500-D

The Commission set the stage for a more rational basis for crediting when it provided exemptions to the crediting mechanism in Order Nos. 500-C and 500-D. The Commission should retain those exemptions, make them permanent and establish a rule whereby crediting is the exception rather than the rule.

1. As NGSA said in its comments to Order No. 500-C, filed January 22, 1988, interstate pipelines should not be permitted to apply credits against any minimum take obligations contained in producer-pipeline contracts. These provisions are generally contained only in those contracts where a minimal level of production is necessary to avoid loss of reserves through reservoir damage or drainage, or will result in the shut-in of oil production. In addition, these provisions protect the

producer against potential forfeiture of leases for lack of production and allow the producer to achieve the economic return on which its investment decision was made. To allow a pipeline to avoid its minimum-take obligation through a credit against that obligation cannot be justified by any so-called short-term public interest benefit.

2. Natural gas purchased for processing plants should be permanently exempted from any form of crediting. All gas processed through the plant should be exempt from crediting, not only percentage of proceeds contracts. The Commission should recognize that there are numerous interest owners of gas behind processing plants that are very minor interest owners. At times, it is impossible to identify and obtain offers of credit from some of these owners. In those cases where a substantial majority of ownership can be identified and offers of credit obtained, the producer desiring to have its gas transported cannot, as a matter of economics, "guarantee" the transporting pipelines that they (the producer) will provide credits to the pipeline attributable to the gas production of others. To impose such a requirement discourages the production of gas and recovery of liquids and the products made from those liquids needed by industries throughout the nation.

3. Take-or-pay credits should not be available to any pipeline not a permanently open-access transporter. Unless the pipeline has agreed to be a permanent open-access transporter in the form of receiving and accepting a blanket certificate for open-access transportation, it should not be entitled to take any credits for transportation of third-party gas. The very premise

behind the Commission's use of the crediting mechanism is that pipelines who transport gas for others on an open-access basis will lose market share while still being committed to purchase gas from producers. This federally-imposed "Catch 22" would be avoided if the pipelines were in some manner relieved of their obligations to purchase from the producers. No such rationale exists for the pipeline who does not agree to become a permanent open-access transporter. If a pipeline elects to transport only under Section 311 of the NGPA, it can flip back and forth between transporting and not transporting, depending on the status of its take-or-pay obligations. Markets would be in a turmoil if this were allowed to happen.

4. Property assignment rules of Order No. 500 unnecessarily restrict the free and fair exchange of property for bona fide business reasons. Producers are not prone to transfer properties simply to avoid crediting regulations. On the other hand, producers may be prohibited from farming out or in properties if to do so subjects the producer to the strictures of Order No. 500 credits. This will indubitably result in fewer exploration and/or development wells being drilled, with the consequent loss of reserves to the market. This will occur at a time when the market is in need of additional gas reserves. NGSA urges the Commission to remove the crediting requirements from property assignments, including farm-outs and farm-ins. The result the Commission seeks to achieve can be done with a requirement that the crediting requirement follow the assignment of a gas purchase contract in the case of a property transfer, and with a close watch on the assignment or farm-out to affiliated producers.

5. Pipelines should be required to give the producer binding, advance written notice of any intent to apply credits to a contract other than the one from which gas was released. While Order No. 500 sought to keep the pipeline releasing gas from taking credit under both the release and for transportation of that same gas, it does give the pipeline a choice of taking the credit pursuant to the terms of its contract with the producer or applying it to any other contract between the pipeline and the producer. Producers are therefore left in a quandary as to which of its contracts will be subject to reduced economics and consequent potential penalty (e.g., through claims for additional royalty) if it causes its gas to be transported. The cross-crediting mechanism adopted by the Commission in its interim rules prevents appropriate gas contract administration by producers. It may be more than a year since deficiencies occurred that the producer is told by the pipeline, and solely at the pipeline's discretion, that there never was a deficiency. Contracts cannot be administered in any rational sense unless the pipeline is required to make a binding election and tell the producer about it before the fact.

6. The Commission should exempt gas from all new wells from crediting. The limited exemption of Order No. 500-C, tied as it is to "marker wells" and depth/spacing requirements, is far too restrictive. The already complex system created by the NGPA should not be burdened by another level of well classification. "New, new" Order No. 500 gas is simply too much. Gas produced from new wells should escape the credit requirement in all events. These new wells may not be drilled at all if they are subjected to the strictures of crediting. Alternatively, the Commission should exempt all new wells

from crediting if drilled on acreage not subject to a contract with the transporting pipeline.

7. Finally, NGSA applauds the Commission's rate design initiative originally promulgated in Order No. 436. Unbundling of rates and assignment of costs to services actually performed according to the use of that service is commendable. However, too often the Commission has retreated from its pronouncements in Order No. 436 and has allowed rates for firm sales and transportation to bear a disproportionately small share of the pipelines' costs compared to the rates for interruptible transportation. NGSA submits that interruptible transportation should not be required to subsidize firm sales and transportation services. The Commission should carefully review rate proposals that come before it to ensure that each type of service provided by the pipeline bears only its own costs.

CONCLUSION

The Commission should re-evaluate the use of crediting as a means of solving the pipelines' alleged take-or-pay problems. NGSA submits that the crediting device, fraught as it is with serious infirmities as a means of providing sufficient quantities of natural gas to markets at the lowest reasonable rates, should be discarded altogether. It should be no more than a tool available to the Commission to ensure that, on a case-by-case basis, pipelines are treated fairly. It should not in any manner be available to extract further concessions from producers who have in fact settled their contract disputes with pipelines on terms mutually agreeable to the parties.

Respectfully submitted:

Nicholas J Bush

Nicholas J. Bush
President
Natural Gas Supply Association
1129 20th Street, N.W.
Suite 300
Washington, D.C. 20036

(202) 331-8900

APPENDIX A

A STATUS REPORT ON THE INTERSTATE PIPELINE TAKE-OR-PAY SITUATION: TRENDS THROUGH 1987 WITH A PROJECTION FOR 1988

April 1988

EXECUTIVE SUMMARY

The Natural Gas Supply Association (NGSA) surveyed its members in March of 1988 to quantify outstanding take-or-pay obligations and the resolution of take-or-pay liabilities. The survey covered the period through year-end 1987, with estimates for 1988.

Major conclusions are as follows:

1. Producers have settled substantial amounts of take-or-pay claims -- a total of $14.5 billion through year-end 1987, or 84% of the cumulative total of $17.2 billion. Of the potential 1988 take-or-pay accumulation of $3.9 billion, producers have settled $3.1 billion, or 81%, of the total. These figures do not include any expected settlements subsequent to March 31, 1988.

2. The implementation of FERC Order 500 is not expected to have the desired effect of enhancing the resolution of take-or-pay accumulations. This is based on the finding that the take-or-pay resolution rates for 1987 (pre-Order 500) and 1988

(post-Order 500) are basically unchanged at 83% and 81%, respectively.

3. The survey results show continuing improvements in take-or-pay resolution rates when compared to previous NGSA surveys. The 1986 NGSA survey reported a 59% cumulative resolution rate versus 71% and 84% resolution rates for the 1987 and 1988 surveys, respectively. These changes reflect the ongoing nature of take-or-pay negotiations, and indicate that the take-or-pay situation is continuing to improve.

4. Take-or-pay exposure is concentrated in a few pipelines. Four interstate pipelines account for 54% of the oustanding take-or-pay liabilities through 1988, while accounting for only 24% of 1987 interstate pipeline field purchases. The top eight pipelines account for 80% of the oustanding liabilities, but only 46% of the pipeline gas purchases. A number of pipelines were found to have only minor or no take-or-pay liabilities.

5. In 1987, over 93% of the gas released by pipelines and sold to other parties was credited by producers against interstate pipeline take-or-pay liabilities. Moreover, those pipelines generally having the highest take-or-pay liabilities had the highest percentage relief through released gas. This reveals the willingness of producers to include volumetric crediting as a resoluton mechanism independent of regulatory requirements such as FERC Order 500, and calls into question the need for such a rule.

6. Pipelines generally have not honored their take-or-pay obligations. Only 3.8% of outstanding take-or-pay obligations to producers have been paid by interstate pipelines through year-end 1987.

7. While the intrastate gas market accounted for 31% of the total gas market in 1987, intrastate pipeline take-or-pay liabilities amounted to only 7% of the total potential take-or-pay liability. This implicates the role of regulation in the interstate market as a major cause for take-or-pay accumulations, and suggests that the appropriate policy for reducing liabilities is to rely upon private negotiations.

The results indicate that the take-or-pay obligations of pipelines are being resolved through negotiations between producers and pipelines. Regulatory interference in the form of Order 500 is not expected to improve the efficiency or speed of resolution.

BACKGROUND

Producer-pipeline contracts for natural gas typically contain a contract quantity below which a pipeline is obligated to pay for the gas whether taken or not. Since the pipeline generally retains the right to take any underlifted volumes within a period of time specified by the contract with no additional payment, the take-or-pay obligations represent prepayments for gas. The cost to the pipeline is the interest cost on the prepayment. These provisions serve to allocate the risk of insufficient demand for the commodity. Producers bear the risk of lower takes down to the take-or-pay level; thereafter, pipelines bear the risk.

In recent years, pipelines have incurred take-or-pay liabilities due to insufficient demand for the gas they contracted to buy. They have argued for legislative or regulatory relief from take-or-pay provisions in their contracts, claiming that these provisions are a severe financial burden for them. In fact, producers have borne a large part of the downturn in demand, since they incur the financial liability down to the take-or-pay level.

Previous to Order 500, substantial pipeline take-or-pay liabilities had been resolved through voluntary producer-pipeline negotiations. In response to market forces, new and renegotiated contracts generally contain lower take-or-pay minimums, and increasingly provide for producers to refund prepayments if the pipeline is unable to take the gas within a specified time period. In order to assess the take-or-pay resolutions and outstanding liabilities, NGSA undertook a membership survey.

METHODOLOGY

The NGSA survey was undertaken in March of 1988 and represents the take-or-pay situation as of March 31, 1988. Twenty-two producers participated and are listed on Table 3. They represent 42% of the total 1987 dry gas production, and 80% of the 1987 interstate pipeline gas purchases from producers1/. In the previous NGSA survey conducted in the fall of 1987, the respondents covered 57% of the 1986 take-or-pay exposure reported by INGAA for the interstate pipelines. Because the set of

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1/ The 80% coverage overstates the actual proportion from the survey participants due to the fact that the sales figures include sales to pipeline marketing affiliates who have made the purchases on behalf of a party other than the affiliated pipeline.

respondents for both surveys is almost identical, the coverage should still be in the range of 50% to 60%.

Information was gathered from each participating producer on its take-or-pay status with each of the 23 interstate pipeline systems listed in Table 2, along with other interstate pipelines, intrastate pipelines, and direct sales customers. Data were collected on take-or-pay liabilities resolved, and deficiencies and payments through year end 1986, for the year 1987, along with an annual estimate for 1988. Unlike the 1987 survey, the current survey did not ask for an estimate of future take-or-pay settlements. Responses were collected and tabulated by an independent accounting firm in order to maintain confidentiality.

Although FERC Interim Order 500 went into effect on January 1, 1988, the current survey did not query producers as to the expected impact of Order 500 on 1988 take-or-pay liability and resolution.

In this survey, resolution refers to the value of take-or-pay obligations which have been resolved by producer/pipeline negotiations. Deficiencies represent the outstanding take-or-pay liability. Payments are the take-or-pay deficiencies actually paid to producers. Original liabilities refer to the sum of outstanding liabilities plus resolutions.

RESULTS

The table below summarizes the state of producer/pipeline take-or-pay resolution:

Resolution Of Interstate Pipeline Take-Or-Pay Liabilities

	Historical Through 1986	Actual Annual 1987	Projected Annual 1988	Cumulative Total
Original Liability (Billion $)	11.81	5.34	3.85	21.00
Liability Resolved (Billion $)	10.01	4.45	3.11	17.57
Percent Of Original Liability Resolved (%)	85%	83%	81%	84%

As these survey results show, producers and pipelines have resolved a substantial amount of take-or-pay obligations. As of year-end 1987, nearly $14.5 billion of $17.2 billion in potential interstate pipeline take-or-pay liabilities incurred were resolved for a cumulative resolution level of 84%.

The implementation of Order No. 500 does not appear to have enhanced the take-or-pay settlement process. In 1987, 83% of all take-or-pay obligations were resolved through private producer/pipeline negotiations. A similar resolution rate is expected for 1988, and is consistent with the view that Order 500 will not have a significant impact on take-or-pay resolutions. Given the complexity and inconvenience caused by the Order 500 cross-contract crediting provisions, as well as the progress of producer/pipeline contract renegotiation, regulatory intervention in the settlement process is not warranted.

The higher level of cumulative take-or-pay resolution reported in this survey (i.e., 84% versus 71% and 59% in the 1987 and 1986 surveys) demonstrates that the resolution of take-or-pay claims has increased over time. The negotiation process requires time to resolve all of the elements associated with pipeline/producer take-or-pay claims. Thus, the level of outstanding take-or-pay liabilities results partly from the inherent delays associated with renegotiating the complex contracts to equitably rebalance the interests of both producers and pipelines. It is not indicative of an intractable situation.

As shown in Table 1, four pipelines account for 54% of the outstanding take-or-pay deficiencies of interstate pipelines expected through the end of 1988. These four pipelines accounted for only 24% of 1987 interstate pipeline field purchases. The next four pipelines ranked by take-or-pay deficiencies account for only 26% of the total interstate pipeline deficiences while accounting for 22% of total 1987 pipeline gas purchases. Thus, eight pipelines account for 80% of the outstanding liabilities and only 46% of the pipeline gas purchases. Table 2 provides a listing of the pipelines included in each of the pipeline groups displayed in Table 1.

The current outstanding take-or-pay liability masks the true progress the industry has made in resolving past and future take-or-pay liabilities. The aggregate results hide the circumstances of individual pipelines. Table 2 shows the pipelines' current ranking according to outstanding take-or-pay liabilities, along with the 1986 and 1987 survey rankings and the percent of producer relief from potential take-or-pay liabilities. The relative ranking of companies has shifted dramatically since the 1986 survey. Several companies that experienced substantial take-or-pay problems have worked to reduce their exposure through voluntary negotiations with producers (both on a historical and prospective basis) and have fallen in the rankings. For example, Trunkline Gas, Southern Natural Gas, United Gas Pipeline, Transcontinental Gas Pipeline, and Columbia Gas Transmission have all fallen by four or more places in the rankings since 1986 survey. Conversely, other pipelines which did not have significant outstanding take-or-pay liabilities in the 1986 survey, have significantly increased their rank -- e.g., Texas Gas Transmission, ANR Pipeline, and El Paso Natural Gas.

Consequently, the absence of a large reduction in the aggregate statistics does not imply that progress is not occurring. Rather, it is indicative of a situation in which pipelines with prior take-or-pay liabilities have significantly reduced their exposure, while pipelines with rather recent accumulations of take-or-pay liabilities have not yet been able to complete the process of renegotiating their contracts with gas producers.

As an additional segment of the survey, respondents were asked to report take-or-pay relief provided by producers through released gas. In 1987, 93% of the gas released and sold to non-pipeline parties provided volumetric relief of take-or-pay exposure. This effectively counters the notion that Order 436/500 has directly resulted in increasing take-or-pay liabilities due to the undermining of pipeline sales by gas transportation. The evidence indicates that, to the contrary, gas transportation is being effectively utilized in conjunction with contract abandonments to grant take-or-pay relief.

Since released gas is largely being credited for take-or-pay relief, Order 500 contract cross-crediting would not make any further significant contribution to take-or-pay resolution. Moreover, as Table 1 demonstrates, released gas is providing the most take-or-pay relief to those pipelines with the highest outstanding take-or-pay liabilities. For example, in 1987, 97% of the gas released by the top 4 pipelines and sold by producers provided take-or-pay relief. In contrast, only 32% of the gas released by the last 3 pipelines provided take-or-pay relief. Generally, the proportion of released gas providing relief diminishes as one goes down in the rankings. This trend demonstrates that take-or-pay relief is being provided through released gas to those pipelines with the greatest need.

The survey indicates that pipelines generally are ignoring their contractual obligations. Through 1987, interstate pipelines made prepayments of only $102 million out of the total outstanding take-or-pay liability of $3.3 billion -- a 3.8% payment rate. The pipelines' true cost of prepayments, however, is only the interest cost of the prepayment since they generally retain the right to take underlifted volumes within a specified future time period. Further, take-or-pay liability settlements via negotiation have ranged between 10¢-20¢ per $1 of liability. Pipelines' statements have significantly overstated the true financial impact of take-or-pay liabilities. Financial performance data reveal that through 1986, the average return on common equity by natural gas pipelines continued well above those of other industries.

By the end of 1987, intrastate pipelines had accumulated significant take-or-pay liabilities, amounting to $1.3 billion. While substantial, this amount is only 7 percent of the total potential take-or-pay liabilities, even though the 1987 intrastate market was 31 percent of the total gas market. The lower intrastate accumulations are a product of a less regulated environment. The much larger size of interstate pipeline take-or-pay liabilities resulted, in part, from a distorted outcome of previous wellhead price regulations which forced interstate pipelines to provide non-cash inducements, such as high minimum take levels, as a means of securing gas supplies. This historical experience is relevant when considering the final ruling on Order 500 cross-contract crediting because non-market solutions to the take-or-pay situation are likely to cause other unintended market dislocations.

CONCLUSIONS

Pipelines continue to advocate legislative or regulatory relief from take-or-pay obligations because they claim that these obligations have created a widespread threat to their financial integrity. However, the survey indicates:

1. the amount of producer take-or-pay relief has grown as the disposition of these liabilities are settled through private contract renegotiations;

2. that take-or-pay liabilities are concentrated among a few pipelines;

3. progress has been made in resolving the take-or-pay issue as companies with significant liabilities have renegotiated their contracts and fallen in the liability ranking; and

4. that over 93% of the gas released by pipelines is providing take-or-pay relief with the highest proportion of relief going to those pipelines with the largest outstanding take-or-pay liabilities.

Take-or-pay provisions in contracts between producers and pipelines serve to allocate the risk of a decline in market demand between contracting parties. Producers have been willing to settle take-or-pay liabilities for less than the full value. Consequently, they have already borne a disproportionate share of the downturn in the industry. They should not have to bear further risk through de facto abrogation of their contracts through FERC Order 500.

Take-or-pay liability accumulations are a symptom rather than a cause of a more fundamental issue -- the decline in gas consumption. Administratively interfering with or abrogating the private resolution process will not ameliorate the underlying cause, but instead threaten the development of future gas supplies as producers absorb a disproportionate amount of the risks that take-or-pay clauses were designed to disperse.

TABLE I

Take-Or-Pay Liabilities Through 1988 And Their Proportions Of The Interstate Market

(Pipelines Ranked By Outstanding Take-Or-Pay Deficiencies)

	Outstanding Take-Or-Pay Deficiencies (Million $)	Take-Or-Pay Resolution (Million $)	Total Potential Take-Or-Pay (Million $)
Top 4 Pipelines	1,857	3,496	5,353
Next 4 Pipelines	878	7,573	8,451
Next 4 Pipelines	361	3,652	4,013
Next 4 Pipelines	223	629	852
Next 4 Pipelines	35	1,841	1,876
Last 3 Pipelines	7	40	47
Other Interstate Pipelines	72	338	410
TOTAL	3,433	17,569	21,002

	Percent Of Total Outstanding Take-Or-Pay Deficiencies	1987 Market Share Of Interstate Pipeline Purchases	Percent Of Gas Volumes Released In 1987 Providing Take-or-Pay Relief
Top 4 Pipelines	54.1%	24.0%	97.3%
Next 4 Pipelines	25.6%	21.9%	96.4%
Next 4 Pipelines	10.5%	7.5%	85.5%
Next 4 Pipelines	6.5%	8.0%	84.6%
Next 4 Pipelines	1.0%	12.0%	74.8%
Last 3 Pipelines	0.2%	3.4%	32.4%
Other Interstate Pipelines	2.1%	23.2%	84.5%
TOTAL	100.0%	100.0%	93.4%

TABLE 2

Interstate Pipelines Included In Each Pipeline Group Shown On The Previous Table

(In Parentheses: the % of T-O-P Liabilities Resolved in the 1987 Survey)

March 1988 Survey	1987 Survey	1986 Survey
Top 4 Pipelines	**Top 4 Pipelines**	**Top 4 Pipelines**
1. Texas Gas Transmission Corp. (50%)	1. Tennessee Gas Pipeline (77%)	1. Trunkline Gas
2. El Paso Natural Gas Co. (49%)	2. United Gas Pipe Line (60%)	2. Southern Natural Gas
3. Tennessee Gas Pipeline (79%)	3. Natural Gas Pipeline Co. of America (44%)	3. United Gas Pipe Line
4. ANR Pipeline Co. (66%)	4. ANR Pipeline (22%)	4. Transcontinental P/L & Gas Supply Co.
Next 4 Pipelines	**Next 4 Pipelines**	**Next 4 Pipelines**
5. Trunkline Gas Co. (91%)	5. Northern Natural Gas (InterNorth) (54%)	5. Northern Natural Gas (InterNorth)
6. Northern Natural Gas Co. (80%)	6. El Paso Natural Gas (39%)	6. Tennessee Gas Pipeline
7. Natural Gas Pipeline Co. of America (89%)	6. Southern Natural Gas (79%)	7. Sea Robin Pipe Line
8. Transco P/L & Gas Supply (98%)	8. Texas Gas Transmission (50%)	8. ANR Pipeline
Next 4 Pipelines	**Next 4 Pipelines**	**Next 4 Pipelines**
9. Southern Natural Gas Co. (99%)	9. Transco P/L & Gas Supply (86%)	9. Arkla
10. United Gas Pipeline (93.6%)	10. Trunkline Gas (92%)	10. Natural Gas Pipeline Co. of America
11. Panhandle Eastern Pipeline Co. (75%)	11. Arkla (29%)	11. El Paso Natural Gas
12. Arkla, Inc. (72%)	12. Sea Robin Pipe Line (52%)	12. Panhandle Eastern Pipeline
Next 4 Pipelines	**Next 4 Pipelines**	**Next 4 Pipelines**
13. Sea Robin Pipe Line Co. (87%)	13. Panhandle Eastern Pipeline (48%)	13. Texas Gas Transmission
14. Northwest Pipeline Co. (21%)	14. Colorado Interstate Gas (48%)	14. Columbia Gas Transmission
15. Colorado Interstate Gas (59%)	15. Northwest Pipeline (10%)	15. Northwest Pipeline
16. Texas Eastern Transmission Corp. (45%)	16. Williams Natural Gas (81%)	16. Transwestern Pipeline
Next 4 Pipelines	**Next 4 Pipelines**	**Next 4 Pipelines**
17. Williams Natural Gas Co. (89%)	17. Transwestern Pipeline (53%)	17. Colorado Interstate Gas Co.
18. Transwestern Pipeline Co. (83%)	18. Florida Gas Transmission (72%)	18. Texas Eastern Transmission Corp.
19. Columbia Gas Transmission Corp. (99.6%)	19. Columbia Gas Transmission (99%)	19. Williams Natural Gas Co.
20. Consolidated Gas Supply Corp. (14%)	20. K. N. Energy (0%)	20. Florida Gas Transmission Co.
Remaining 3 Pipelines	**Last 2 Pipelines**	**Last 2 Pipelines**
21. Florida Gas Transmission Co. (91%)	21. Consolidated Gas Supply Corp. (0%)	21. K.N. Energy
22. K.N. Energy (26%)	22. Texas Eastern Transmission (99%)	22. Consolidated Gas Supply Corp.
23. Williston Basin Interstate Pipeline (83%)		

TABLE 3

Natural Gas Producers Participating In The 1987 NGSA Take-Or-Pay Survey

1. Amoco Production Company
2. Anadarko Petroleum Company
3. ARCO Oil & Gas Company
4. Cabot Corporation - Oil & Gas Division
5. Chevron U.S.A., Inc.
6. Cities Service Oil & Gas Corporation
7. Conoco, Inc.
8. Exxon Company, U.S.A.
9. Hamilton Brothers
10. J. P. McHugh & Associates
11. Kerr-McGee Corporation
12. Marathon Oil Company
13. Maxus Exploration
14. Mobil Oil Company
15. Pennzoil Company
16. Shell Oil Company
17. Sun Exploration & Production Company
18. Tenneco Oil Exploration & Production
19. Texaco, Inc.
20. UNOCAL Corporation
21. Union Pacific Resources (formerly Champlin Petroleum)
22. Union Texas Petroleum

Statement of
Danny Conklin, Chairman
Independent Petroleum Association of America

Before the Senate Committee on Finance
April 13, 1988

I am Danny Conklin, a partner in Philcon Development Company of Amarillo, Texas, a crude oil and natural gas exploration and production company which realizes 85 percent of its revenues from wellhead sales of natural gas. I appear here today as Chairman of the Independent Petroleum Association of America (IPAA).

The IPAA is a national association of some 6,500 independents, domestic explorer-producers of crude oil and natural gas. Virtually all of the activity of the IPAA membership is confined to the lower 48 states of the United States.

We are joined today in these comments by a number of unaffiliated state and regional oil and gas associations listed on the cover page. The combined membership of these associations includes nearly all of the 12,000 U.S. independent oil and gas producers.

We appreciate this opportunity to appear before you on the subject of the pending, proposed U.S.-Canada Free Trade Agreement (FTA). At the outset, let me say that on its face, the FTA does not change the ground rules of natural gas trade with Canada. In the normally understood meaning of "free trade," we currently have free trade with Canada and the FTA does not make any significant changes in the status quo.

However, for some time, we have not had fair trade and the FTA does nothing to remedy inequities in the regulatory scheme of gas production and transportation which is creating the inequities. Thus, the IPAA believes that the current debate over the FTA, and the focus it gives to U.S.-Canadian relations, is an excellent setting in which to seek fair trade.

Before turning to the specifics of the Free Trade Agreement, we should reflect on the history and current status of U.S. Canadian energy trade.

Historic trends.

The Canadians have not been complacent suppliers of energy to the United States and have protected their own self-interests both as to price and availability of their exports. We should not forget that during the crude oil shortages following the 1973 embargo, specifically beginning in March, 1973, Canada severely limited crude oil exports to the United States. Later in the 1970s, when the United States faced natural gas curtailments, the Canadian government intervened in the private contracts at the border to establish a floor price which reached as high as $4.94 per MMBtu, which was approximately three times the average United States price for natural gas and approximately four times the controlled price in Canada for intra-

Canadian sales at that time. Also during this period, Canada limited the amounts of gas which could be exported to the United States by requiring that very high amounts of reserves be established before any volumes were eligible for export.

Consider even more recent history. For the period 1981-85, the relative prices of United States and Canadian gas are summarized on Table I. This table shows that Canadians, either through direct contract prices or manipulation of rate structures, expect to be able to sell gas to the United States at above competitive domestic prices whether the United States is experiencing either surpluses or shortages. When supplies are tight, the Canadians either have refused to sell to us or have limited the amounts sold and demanded above-market prices. Yet, as now, when United States markets are soft, the Canadians claim that "the reliability" of their supplies justify prices which are in excess of the unit price of available domestic supplies.

The current imports.

According to the Energy Information Administration (EIA) the average wellhead price for domestic gas in August was $1.71 while the imported average gas price for that month was $2.17. Similarly, the EIA's projected surplus deliverability of domestic gas is 1,441 Bcf for the six-month period beginning October, 1987. Notwithstanding this deliverability surplus, a total of 850 Bcf of gas was imported during 1987.

Gas is being imported from Canada under a variety of arrangements. First, a series of long-term contracts with interstate pipelines in many cases extend through the year 2000. These contracts contain onerous take-and-pay clauses. Under the terms of such clauses, if the take-and-pay quantity is not taken during the period specified by the contract, the importer must pay for the gas without any opportunity to make up the payment. (In contrast, the Federal Energy Regulatory Commission (FERC) requires a minimum of a five-year make-up period in its jurisdictional contracts.)

Second, gas is imported under a series of spot gas or released gas arrangements. The duration of specific transactions vary from one month to two years. Such sales are made to distribution companies and to end-users, without any Commission rate review.

The Free Trade Agreement.

With this background, let us turn to the terms of the United States-Canada Free Trade Agreement. The agreement itself does not mention "natural gas." Instead, it is drafted in terms of "energy goods" and uses definitions from the General Agreement on Tariffs and Trade (GATT). We support the specific objectives listed in the Preamble of the Agreement including, "TO REDUCE government-created trade distortions while preserving the Parties' flexibility to safeguard the public welfare." Also note that Article 102 lists as an objective to "facilitate conditions of fair competition within the free-trade area." However, as we will discuss later, many practices and policies which presently provide Canadian gas with unfair advantages will have to be corrected if these worthy goals are to be achieved.

One item conspicuously absent from Annex 905.2 of regulatory changes is the Commission's decision in *Natural Gas Pipeline Co. of America,* Opinion No. 256. We have been assured by the administration that this indicates that nothing in the Free Trade Agreement will overturn this important Commission action. However, in a recent Washington speech, a representative of the Alberta government indicated that one of the first items to be brought before the binational dispute resolution procedure will be Opinion No. 256. Accordingly, we urge the Congress to clarify in the course of developing its legislative history on this agreement that Opinion No. 256 will remain intact.

A little background may be in order on the importance of Opinion No. 256 to the independent producer. Pipelines charge their distributor customers two rates: a demand charge based on the maximum volume that a customer contracts to purchase, and a commodity charge based upon the actual volumes purchased. All producer charges are recovered in pipeline commodity rates. However, many long-term import contracts were renegotiated to shift from a one-part rate to a two-part rate, with the pipelines seeking "as billed" treatment of the Canadian gas costs. In this manner, only the commodity portion of the border price would be recovered through the pipeline's commodity rate. Because over the short term, pipelines compete based on commodity rates and not on total costs, "as billed" treatment would give Canadian gas a substantial marketing advantage. For example, in California, where Canadian gas has been from 50 to 80¢ more expensive on a unit cost basis during 1985 and 1986, the Canadian gas was taken first under the California Public Utilities Commission (CPUC) sequencing rules because it had a lower commodity price than domestic gas. Taking data from Southern California Gas' (SoCal) reasonableness review application, the average cost to SoCal from its three long-term supply sources during the period July,1985, through June, 1986, were:

Supplier	Unit Cost
El Paso Natural Gas (domestic)	$3.213
Transwestern (domestic)	$3.404
Pacific Interstate Transmission (import)	$4.179

Although Pacific Interstate Transmission (SoCal's affiliate importing Canadian gas) was the highest priced supply, it first came under the CPUC sequencing rules. Opinion No. 256 held that pipelines were not free to shift Canadian costs to their demand charges. Instead, when constructing the pipeline's citygate rates, the Canadian gas costs would be reallocated between demand and commodity rates based on FERC-approved rate principles. Under the Opinion No. 256 approach, Canadian gas costs would be subject to the same competitive pressures as domestic gas on a "level playing field."

What started out as a cut-and-dried academic ratemaking decision then was elevated by the Canadian government into an international incident. It is difficult to justify having an ***independent*** regulatory body making rate decisions if anytime it decides a case adverse to Canadian interests, the Canadians seek assistance from the highest levels of our government. Much to the Commission's credit, it resisted such political pressure and held to its decision. Given this history of attempts to politicize the objective decision-making process, we are very troubled by the energy consultative mechanism in Article 905, which is separate from the overall consultative mechanisms of the Agreement. The Congress should use this opportunity to reaffirm the Commission's role as an independent agency, and the fact that the Agreement represents the understanding of both governments that Opinion No. 256 will remain.

One adverse effect of recent settlements between Canadian suppliers and U.S. importers are contract amendments which guarantee the supplier a stated percent of the importer's market. Under these agreements, domestic producers will not be able to expand their market share regardless of how much lower their prices are. For example, Northwest Pipeline Company entered into a settlement with Westcoast (a Canadian exporter) which guaranteed a 45% market share. ProGas (a Canadian exporter) has been guaranteed a 2.75% share of ANR's market through October 2000.

One would assume that such agreements would be subject to regulatory oversight as are agreements between domestic producers and pipelines. However, the FERC has claimed that once a transaction is approved by the Economic Regulatory Administration (ERA), it is not subject to prudence reviews in subsequent pipeline rate cases. Unfortunately, the ERA also refuses to review these guarantees on the grounds that it does not want to interfere with freely-negotiated contracts. Of course, if the pipelines are guaranteed recovery of Canadian gas costs in downstream rates, the pipelines have no incentives to drive a hard bargain in such negotiations. Either the pipeline's customers will bear the extra costs or, more likely given the present competitive conditions, the pipeline will lower the prices paid to domestic producers to assure that its overall mix of gas will remain marketable. Thus, domestic producers are subsidizing these non-market responsive import arrangements.

The above problems arise from the professed application of traditional regulatory principles. However, regarding the Alaskan Natural Gas Transportation System (ANGTS), all bets are off and the Commission repeatedly has granted ANGTS unique concessions on the grounds that the ANGTS is *sui generis*. Even though the prospects are slim that the ANGTS ever will be built, those concessions remain and Canadian importers are seeking to exploit them to assist in the marketing of Alberta gas through the "prebuild" portions of the ANGTS. For example, Northern Border, the "prebuild" of the Eastern leg, has a cost of service tariff where all operating costs plus a guaranteed return of and on equity is recovered through the demand charges of Northern Natural, Panhandle, and United. When a normal pipeline transports gas under Order No. 500, the Commission requires that a 100% load factor rate be charged for interruptible transportation, and any rate discounts are borne by the shareholders of the pipeline. In contrast, on Northern Border, the 100% load factor rate would be about 64¢, which Northern Border concedes would render the Alberta gas unmarketable in the Midwest. So, the Commission allows Northern Border to discount these rates, but the discount is borne by the customers of Northern Natural, Panhandle, and United instead of the shareholders until the discount reaches the level of 40¢. Thus, domestic producers and consumers subsidize the transportation of the Canadian gas.

Adding to this, under Opinion No. 256, the Commission will adjust Canadian pipeline transportation charges to conform to the Modified Fixed-Variable (MFV) rate design. However, Northern Border and the other prebuilt segments are not on the MFV rate design. This results in costs which should be included in the Canadian gas commodity charge being reflected instead in its demand charge. Presently, various parties are challenging this before the FERC, but we would hate to see the Free Trade Agreement used as a pretext for retaining this unfair rate design distortion which benefits Canadian gas.

It is ironic that Northern Border continues to claim special privileges as an ANGTS pipeline after the Alaskan segment has been postponed indefinitely. In fact, Northern Border's recent expansion application which would extend the pipeline from Ventura, Iowa, to Tuscola, Illinois, not only deviates from the Presidentially-approved route, but also demonstrates that Northern Border is becoming a pipeline for transporting spot market gas instead of a pipeline structured to transport Alaskan gas. Of course, it remains to be seen who will end up bearing the burden of Northern Border's proposed $534 million expansion.

Domestic producers must make extensive capital investments "up front" on exploration and development. They finance these efforts in large part based on long-term contracts with purchasers. Take-or-pay clauses play an important role in such financial arrangements. Unfortunately, the recent FERC Order No. 500 series has the effect of abrogating many of these contractual relationships. (The effect is so severe that the FDIC, which represents the interests of many production properties that have been foreclosed, was prompted to seek a waiver from the terms of Order No. 500 from the FERC.) While not advocating a continuation of the cross-crediting provisions of Order No. 500 any longer than would otherwise be the case, it is important to note that because Canadian production must be held in a separate corporate entity, Canadian gas is not subject to cross-crediting with U.S. production under Order No. 500. This gives Canadian gas a tremendous marketing advantage. Similarly, the Commission in recent orders has prohibited, as a general rule, recovery of take-or-pay settlement costs in pipeline demand charges. However, take-or-pay settlements of border contracts have been allowed to shift settlement costs into pipeline demand charges with impunity. Again, a policy on take-or-pay settlement costs which treat domestic and Canadian gas fairly is needed.

A fundamental flaw in the current regulation of transactions at the border is the assumption that market forces will somehow solve all of our current problems. This assumption is undercut by the many affiliate relationships present at the border. For example, Pacific Gas and Electric purchases its Canadian gas from its affiliate Alberta and Southern. The gas then is transported through another affiliate, Pacific Gas Transmission. Pacific Gas and Electric's primary concern is not the lowest cost gas for its customers, but rather looking out for its affiliates' business interests. Hence, rates are structured to take Canadian gas while less expensive domestic supplies are available. Because ownership of import-related pipeline projects is so pervasive, it is difficult to identify interstate pipelines that have no financial interest in the outcome of policy decisions which confer advantages to Canadian gas. As a result, only the producing and consuming segments of the industry are left to speak out against the current inequities.

Because many transactions, including the "spot market" blanket transaction, occur through affiliates, the regulatory structure cannot assume that these arrangements resulted from arms-length transactions. In addition, because the ERA has granted substantial blanket import authorizations to the unregulated marketing affiliates of many interstate pipelines, these affiliates are in a position to capitalize on the monopoly power arising from their affiliates' control of border facilities. In general, much work is needed to address the abuses by pipeline marketing affiliates, and we look forward to the Commission's rule on this subject. However, we fear that the rule will not address the special problem of affiliate transactions at the border and that either the ERA will continue to refuse to work on the problem or that any FERC action will be thwarted by the Canadian's misuse of the procedures established under the Free Trade Agreement.

Conclusion

While we know it is not covered by the agreement, we did want to bring to your attention some existing discrepancies in the tax treatment of Canadian and U.S. producers.

We know that the negotiators agreed not to try to assess the relative equity of the two nations' tax codes and production incentive programs. Instead, they provided a mechanism for aggrieved parties on either side of the border to seek trade relief action -- and possible equity through countervailing duties.

However, and again in the interest of fair trade at a time we are talking about free trade, we are urging the Congress to consider significant changes in the tax code to put U.S. producers on a more even footing with their Canadian counterparts.

For example, Canada wisely has repealed its windfall profit tax. Our Congress should do the same. Canadians have a much milder form of alternative minimum tax (individual rates are 17 percent and there is no corporate AMT) and drilling expenses in Canada are not treated as preference items. Canada also offers its producers exploration tax credits. We should not do less.

In conclusion, again we would repeat our plea -- if it is time for free trade with Canada, and it probably is, then it is time for fair trade. We hope you agree and will help us to bring about the legislative and regulatory changes necessary to give domestic producers fair treatment.

Thank you.

Table I

Year	Alberta Border Price	Toronto Wholesale Price	Border Export Price	Domestic Wellhead Price
1978	NA	NA	$2.21	$ .91
1979	NA	NA	$2.60	$1.18
1980	$1.48	$2.10	$4.47	$1.59
1981	$1.56	$2.57	$4.94	$1.98
1982	$1.75	$3.10	$4.94	$2.46
1983	$2.16	$3.36	$4.40	$2.59
1984	$2.30	$3.23	$3.40	$2.66
1985	$2.16	$2.93	$3.15	$2.51
1986	NA	NA	$2.51	$1.94

PREPARED STATEMENT OF BENJAMIN Y. COOPER

BEFORE THE

SENATE COMMITTEE ON FINANCE

April 12, 1988

TESTIMONY

Mr. Chairman and Members of the Committee, I appreciate the opportunity to appear before you today in support of the Free Trade Agreement between the United States and Canada. My testimony today is presented in behalf of the Printing Industries of America and the National Association of Printers and Lithographers. Together these two organizations represent over 15,000 printers in the United States and over 90 percent of the sales of the U.S. printing industry.

The U.S. printing industry is one of the nation's largest industries with over 35,000 establishments. Value of shipments for these firms in 1987 was $62 billion. The industry employs 770,000 persons. To put these figures in perspective, the U. S. printing industry employees over 350,000 more workers than the computer industry, and sales of the printing industry exceed that of the computer industry by $3 billion. Despite its large size, the U. S. printing industry is dominated by small firms, with the average firm having only 22 employees.

The support of the U. S. printing industry for free trade with Canada is not a new issue. For the past 20 years, the Printing Industries of America and other associations in the industry have worked to convince the Canadian government to remove discriminatory trade barriers between the two countries. Our zeal for free trade with Canada is obvious when one considers that over half of our exports in printing go to Canada. In 1987, the U. S. exported $750 million in printed products to Canada. It becomes even more obvious when one realizes that the trade barriers imposed by Canada on printed products defy description. The following is capsule of the barriers we currently face:

Tariffs - The tariffs on printed products are the highest of all Canadian tariffs with the highest being a 28.6 percent tariff on catalogs followed by a 24.3 percent tariff on advertising products;

Postal Rates - Magazines and Newspapers printed in the United States but mailed in Canada pay postal rates up to six times the rate paid by publications printed in Canada;

Import Restrictions - U. S. printed publications containing more than 5 percent of its advertising content directed at a Canadian audience may not be brought into Canada.

The U. S. maintains no trade restrictions even remotely similar to these barriers. We have no tariffs on catalogs, our advertising tariff is 4.9 percent, and the only non-tariff barrier in the U. S. to printed products is a prohibition on the import of lottery tickets printed outside the U. S. Essentially, the U.S. has achieved free trade. We are merely waiting for Canada to join us.

Clearly, the approval of the Free Trade Agreement is beneficial to the U. S. printing industry. Under the Agreement, all tariffs would be eliminated in 5 years. By our estimates, approximately $500 million in new business could be made available to U. S. printers if these restrictive tariffs were eliminated. In view of the fact that U. S. printers exported $750 million in 1987 to Canada, such an increase would be tremendous.

As pleased as we are with the overall achievements for the U.S. printing industry with the Free Trade Agreement, we regret that more progress was not made with regard to the non-tariff items. The discriminatory postal rates and import prohibitions will continue after the signing of the Agreement. Regrettably, the barriers to trade are covered under that enormous umbrella known as "cultural sovereignty." In the negotiations, Canada evidently accepted the U.S. printing industry's argument that printing is not a "cultural" industry but would not go so far as equating postage rates and advertising restrictions with printing. Instead these apparently were viewed as publisher issues. It is true that publishers are affected by the restrictions, but the prohibition itself primarily relates to the place of the printing.

Despite these restrictive tariff and non-tariff barriers, the U. S. printing industry has managed to maintain a favorable balance of trade with Canada for a number of years. As the accompanying material indicates, the favorable balance has been in the area of books and periodicals. It should come as no surprise that these are also the areas where there are no tariffs. These are clearly major product areas for the U. S. printing industry, but the key statistics to review are the negative balances in catalog and "all printing" categories which are the "heart and soul" of the U.S. industry. Advertising printing represents 30 percent of the U. S. industry and catalog printing 14 percent (compared to magazines at 17 percent and books at 5 percent). Yet, our exports in these areas are limited. We believe these limitations are due almost entirely to the excessive Canadian tariffs on catalogs and advertising material.

Elimination of the tariffs between the U. S. and Canada would resolve the problems with catalogs and general commercial printing. While this change would be immediately beneficial to printers along the U. S./Canadian border, the long term benefit would be found throughout the economy as U. S. companies would buy U. S. printing to support the products they sell into Canada. Currently, there is an advantage for a U. S. company selling into Canada to use a Canadian printer to produce the advertising and descriptive materials to accompany the products.

The postal rate issue was an interesting one to follow since its was announced that an agreement had been reached on discriminatory postal rates. Canada initially agreed to remove the higher rates for U. S. printed publications but apparently reconsidered. The negotiations later turned on the phrase "substantial circulation." In other words, discriminatory rates would be eliminated for substantial circulation publications but not for smaller magazines. The circulation figure Canada indicated it would accept was 100,000, eliminating all but three magazines (according to our information) from favorable consideration. It was our feeling that the U. S. was better off with no agreement than an agreement which further discriminated against U.S. printers and publishers.

As stated in the beginning of this testimony, the U. S. printing industry is strongly supportive of this Agreement. Our efforts to achieve freer trade with Canada have included legislative attempts to remove barriers or to raise ours to an equivalent level. Additionally, in 1987, the Printing Industries of America drafted a Section 301 Petition against Canada specifically naming the trade barriers listed on pages one and two of this testimony. We never filed that petition, instead preferring to work within the context of a Free Trade Agreement. If this Agreement is not approved, we will have to reconsider whether to file that complaint. Regardless of the outcome of the Agreement, we must also consider whether it will be necessary for us to proceed with the "301" Petition to attempt to have the other barriers removed.

We would hope the Congress would seriously consider continuing to work with Canadian officials to address, in particular, the postal rate issue. Clearly, the U.S. Postal Service has problems with revenue, and yet we do not punish foreign printers and publishers who wish to mail in this country. Perhaps we should consider such increases in the future for those nations which impose inequitable restrictions on the U. S.

In conclusion, we urge your support and prompt ratification of the Free Trade Agreement. The fact that we are unhappy with aspects of the Agreement is part of the give-and-take that goes into any negotiations. We ask, too that, as you consider the outcome of this matter, you look to industries such as printing. Industries such as ours pay little attention to trade. With few exceptions, our members know little about export. They only know that they see Canadian printers competing for work they have been doing. They do not mind the competition. They are used to it. However, they do object when they have no opportunity to compete for work in the country of the competitor.

U.S. - CANADA TRADE IN PRINTED PRODUCTS 1975 - 1986 (MILLION U.S. $)

Year	Total		Books		Periodicals		Catalogs		Newspapers		Advertising Printed Matter		All Other Printed Matter[1]	
	U.S. Exports	U.S. Imports	U.S. Exports	U.S. Imports	U.S. Exports	U.S. Imports	U.S. Exports	U.S. Imports	U.S. Exports	U.S. Imports	U.S. Exports	U.S. Imports	U.S. Exports	U.S. Imports
1986	579.5	393.4	206.3	104.3	265.4	51.0	5.8	33.2	14.9	96.7	14.0	n.a.	73.1	110.2
1985	598.0	321.2	240.3	87.4	255.7	31.4	6.2	34.4	13.5	82.0	13.7		68.6	86.0
1984	646.5	281.7	261.7	84.2	268.9	12.0	7.8	46.2	13.7	82.0	18.3		76.1	57.3
1983	610.2	228.3	240.3	81.2	243.8	9.0	7.2	22.8	14.4	68.7	14.5		90.0	46.6
1982	592.0	167.6	240.6	47.5	239.4	6.2	6.2	15.7	13.0	60.8	13.3		79.5	37.4
1981	558.2	142.4	224.0	39.3	223.3	10.1	6.1	12.4	10.3	49.3	11.9		82.6	31.3
1980	481.8	133.1	193.8	39.9	197.2	27.6	5.5	10.1	9.4	34.0	10.8		65.1	21.5
1979	447.8	91.4	180.1	23.6	191.2	24.6	4.2	6.9	7.6	18.2	8.6		56.1	18.1
1978	394.5	81.4	149.0	15.6	166.1	10.5	4.4	6.3	5.5	35.4	9.3		60.2	4.3
1977	346.1	66.0	151.0	11.5	132.7	5.6	3.7[2]	3.5	6.1	33.2	11.6		41.0	12.2
1976	310.9	65.0	145.1	20.2	113.4	5.9	2.8[2]	3.2	4.3	25.5	11.0		34.3	10.2
1975	262.1	50.4	120.0	11.9	99.0	6.7	2.8[2]	3.9	3.4	18.6	9.5		27.4	9.3

n.a. - Not Available

1) Includes posters, labels, decals, albums, blankbooks, calendars, postcards, greeting cards, maps, charts, globes [illegible]

2) Includes directories, 1975-1977.

Note: Does not include individual shipments valued under $500 (exports).

Source: U.S. Department of Commerce, Bureau of the Census

W. Lofquist, 2/24/88

WORLD WIDE
($ MILLIONS)

1986	1,341.9	1,466.7	604	701.4	381	111.1	18.2	107.8	19.9	95.6	44.4	n.a.	274.4	450.8

Ri[illegible] [illegible] [illegible]perton, Executive Director

Independent Zinc Alloyers Association, Inc.

The United States-Canada Free Trade Area Agreement (FTA) is an economic marriage of over 200 million people in the U. S. to over 20 million people in Canada. It is an historic document.

The FTA is acclaimed in many quarters of both our countries as good for the United States and good for Canada and the foundation of a North American production and trading bloc.

It is a bilateral document between two strong allies. However, to our other allies and to the rest of the world, it can be viewed as a unilateral action and a signal to developing countries that the U. S.- Canada bloc can become largely self-sufficient in natural resources, production, consumption and trade. The FTA may be a step toward the economic isolation of U. S.-Canada.

As a case in point, examine only the tariff section of the Agreement. As tariffs between the two nations dwindle away and trade between our two countries intensifies, the tariffs of the United States and Canada will continue to stand against the rest of the world. We become something of a monolith within which those U. S. companies that rely upon foreign sources for raw materials must look only to Canada because of advantageous prices as the result of fallen tariffs. Sources outside the FTA will be kept out by our joint tariff walls.

Canadian zinc producers may have a double incentive to market zinc alloy in the United States as a result of the FTA. As the 19% ad valorem duty on zinc alloy falls, they may wish to take advantage of their substantially lower production costs to compete with U. S. independent zinc alloyers. Secondly, since there may be a shortage of imported producer zinc for alloyers at the Canadian price, Canadian producers may have to supply zinc alloy to the U.S. to make up any shortfall.

In either event, U. S. independent zinc alloyers may lose their markets to Canadian companies who then will have the benefit of our 19% duty against the rest of the world's zinc alloy producers.

The Canadians may have found some answers to these dilemmas. The Economic Council of Canada, a Crown Corporation whose members are appointed by the Prime Minister, has just published the results of a study titled: Managing Adjustment, subtitled Policies for Trade-Sensitive Industries. *

It is intended as a guide for governments. It is a study from which our government trade institutions can benefit. Since it will likely guide one side of this trade marriage, Canada, it ought to have great relevance and usefulness to our side.

The Council, writing in the Foreword to the report, enumerates the difficulties governments have had in international trade areas with the growth and liberalization of trade from the end of World War II to the present. A brief paragraph at the opening of the study report states:

"The purpose of this study is not only to assess the amount of change that is taking place but also to examine the appropriate role for governments in fostering adjustment and in moderating its more painful side effects."

Admitting that Canadian subsidy and capital investment policies may have been mistakes and done as much to hinder as to help trade-sensitive industries the report also says:

"Quota restraints provide both labour and capital with time to adjust. To the extent that an import surge is likely to cause 'serious injury' there is a rationale for giving industry a breathing space in which to adjust. Consequently, we support the use of quotas to assist industries adversely affected by international competition, provided that Canada corrects the mistakes of the past."

Canada already has launched this policy in anticipation of the implementation of the FTA.

In January, the Canadian government circumvented the FTA by restricting exports from the U. S. of ice cream, ice milk, yogurt, skim milk and buttermilk. In effect, Ottawa placed a quota on certain dairy products to protect its domestic industry form U. S. competition.

More recently, as we all know, the Canadian government has granted tariff relief to its textile industry which, while it may be legal under the FTA, does not support the intent of the agreement.

The Prime Minister of Canada and his government advocate the broadest possible free trade arrangement between our two countries. Nevertheless, the Economic Council of Canada, appointed by the Prime Minister, publicly recommends the use of quotas to assist Canada's trade sensitive industries. Mr. Chairman and members of the Committee, I urge you to consider in the enabling legislation corresponding measures to assist U. S. import sensitive industries.

Prior to World War II the United States was isolated economically and militarily. The vast resources and production capabilities of this country enabled us to be the arsenal of democracy and to end our isolation. Today, lacking resources and with greatly reduced production capabilities, we seem to be reaching backward by using bilateral trade agreements to re-isolate ourselves. First, in close economic alliance with Israel, and now with our great ally Canada.

Independent zinc alloyers, all small firms and all but one family owned, as a result of the FTA, may lose their meaning and their role as part of the American industrial base.

*The report is available from the Canadian Government Publishing Centre.

TESTIMONY OF SENATOR PETE V. DOMENICI

BEFORE THE SENATE FINANCE COMMITTEE

APRIL 13, 1988

Mr. Chairman, in the months ahead the Congress will consider the U.S.-Canada Free Trade Agreement. It is an historic agreement, one creating a single market that reaches from above the Arctic Circle to the Rio Grande.

These landmarks give the mind's eye a vivid description of just how far this Agreement reaches. But dollar figures provide an equally impressive measurement of the significance of the Agreement. The bilateral trade between the United States and Canada in goods totaled $124 billion in 1986.

American exports to Canada exceed our exports to the entire European Community. They are more than double those to Japan. In fact, our trade with the province of Ontario alone exceeds our trade with Japan.

Clearly, this is a very important agreement and deserves the careful study of every Senator.

I have introduced legislation that I believe is absolutely essential if this Agreement is to prove effective and fair.

The United States and Canada are more than neighbors. We are friends and allies. President Reagan characterized the relationship as "kin who together have built the most productive relationship between any countries in the world today." For the United States, close economic ties with its largest trading partner are important; for Canada, with three-quarters of its trade going to the United States, those ties are essential.

This Agreement would create the largest free trade area in the world. I think the President should be commended for pursuing the idea. I believe firmly that as the United States and the world wrestle with how to best compete in the global market place, this bilateral agreement is likely to prove an invaluable blueprint.

This Agreement is even more important because it will be the first bilateral Agreement since John Naisbitt told us that a major "megatrend" of the future would be competition in a global economy.

The handling of this Agreement is critical to our future because it will be the model for Agreements with other major trading partners. Its strengths and weaknesses will be magnified because they will almost certainly be repeated elsewhere. They will be repeated simply because we are at a critical juncture of moving into a global economy. This Agreement will be extensively discussed in the new trade round. It will be the "mark-up document" or "terms of reference" for beginning free trade agreement negotiations with Mexico, Japan, China, and other key trading partners.

For that reason we can't afford to make mistakes, or to overlook the shortcomings of the Agreement. We must hone this Agreement, the implementing language, and policies we pursue as a result of the agreement as closely as we can, because this Agreement will be the precedent. It will set both the tone and content for future negotiations.

Secretary Baker testified before the House that the United States was able to get 9 out of 10 negotiating objectives. That's pretty good. But it isn't good enough when you think about this agreement as the prototype for our transition into a global economy.

I have been told by Administration officials that they can't go back and renegotiate weak provisions. I met with the Canadian Ambassador and he said that it isn't politically possible for his government to "give" on any additional areas.
The text of the Agreement must stand or fall as written.

The Congress will be asked to vote on this Agreement, without amendments. Is this a good Agreement? Yes or No?

My law professor used to say that in a good agreement, all of the "whereases" lead logically to the "therefores."

By this standard, the Free Trade Agreement is not a good agreement. Chapter Nine is the Energy chapter of the Agreement. In a most glaring manner, the "whereases" fail to produce the "therefores."

While the Energy Chapter is only 1 of 20 chapters in the Agreement, U.S.-Canada trade in energy is the largest in the world. Its value exceeds U.S. bilateral trade with nearly all of our other trading partners.

The major purposes that are stated for this agreement include the following:

* Promoting productivity, full employment, and steady improvement of living standards for citizens employed in their respective countries;

* Ensuring a predictable commercial environment for business planning and investment; and

* Strengthening the competitiveness of U.S. and Canadian firms in global markets.

The Agreement's further objective is to create the proverbial "level playing field." Under the Agreement, all tariff barriers would come down, and the U.S. and Canada would become a single market operating under the same rules.

That sounds fabulous. But the one negotiating objective the U.S. failed to obtain from the Canadians was any significant concessions on subsidies.

In the oil and gas exploration area, these subsidized incentives are very significant. For example:

* Canadian "royalty holidays," when royalty payments are suspended or eliminated, are provided for production from any wells spudded between October 1986 and November 1989. These holidays are available for exploration wells and the holidays can last for up to five years. By contrast, The U.S. has Federal and state royalty rates that range from 12-1/2 to 25 percent.

One U.S. producer has calculated that the total U.S. royalty burden stands between 22 and 25 percent, counting Federal, state, county and even school board levies. In contract, he estimates the burden on small to medium sized independents in Alberta, Canada --- the source of more than four/fifths of Canadian oil and gas production --- stands between zero and 5 percent.

Is this a level playing field?

* Alberta Royalty Tax Credit Program for small producers was enriched by $67 million in 1987 and Saskachewan introduced a price sensitive royalty rate structure resulting in reduced royalties when prices are low, and a flat royalty of 1 percent for wells producing less than five barrels per day. The United States has nothing comparable.

Is this a level playing field?

* Canada allows up-front tax deductions on all geological and geophysical costs. The U.S. requires them to be capitalized over the life of the well.

Is this a level playing field?

* Under the Agreement, restrictions on U.S. investment in Canadian oil and gas exploration companies will remain in place. The U.S. has no comparable restrictions.

Is this a level playing field?

And there is lots more. Canada repealed its Windfall Profits Tax. And though a similar repealing provision has been approved by House and Senate Conferees in the Omnibus Trade Act, the U.S. has yet to do so. If this legislation becomes law, repealing the Windfall Profits Tax would be a step in the right direction but it would not be enough.

And the Canadian Exploration and Development Incentive Program provides direct cash assistance to the petroleum industry For every $2 of exploration and development dollars a Candaian firm puts up, the Canadian Government puts up $1 up to $10 million per firm. We have nothing comparable.

Are these indicators of fairness, a level playing field?

The Agreement allows the U.S. and Canada to keep in place its existing incentives and to enact additional incentives for oil and gas exploration, development, and related activites in order to maintain the reserve base for these energy resoures.

What happened to fairness here?

The U.S. Department of Energy which has clearly been in the forefront of those calling for approval of the Administration's Agreement recently drafted a study comparing U.S. and Canadian tax and fiscal treatment of oil and gas production. They are sitting pretty tight on this because they know that their conclusions don't match what they preach. Let me quote directly here from their findings. It says, "It appears that small producers operating within the limits of Canada's incentives programs will experience lower overall tax and royalty obligations than comparable producers operating in the United States." What this means is that small producers, who happen to be the majority in my state of New Mexico, and in our country, loose out to Canadian producers. And let's not forget that independents in this country drill 90% of wild cats and 75% of development wells. Add to this the fact that about half of U.S. production and half of the reserves in oil and gas are in the hands of the independents, and one begins to see the seriousness of the problem. They are having a very tough time as it is with the way the market is now, and this Agreement is about as welcome as another OPEC crisis.

If you agree with me that this clear lack of parity is a major weakness of the Agreement, I hope you will support in sponsoring the "U.S. Canada Free Trade Agreement Oil and Gas

Incentive Equalization Act of 1988." This bill has eight cosponsors including my good friend from Oklahoma, Senator Boren.

I would have prefered that the negotiators go back and eliminated the subsidies and other incentives so that the oil and gas companies on either side of the border can have comparable government subsidies or incentives.

But that is not possible. The only alternative that I can propose is to pass legislation before or at the same time as the Free Trade Agreement, legislation that provides catch-up incentives for the U.S. oil and gas industries.

My bill specifically seeks to conform the intent of the Agreement with the realities of the oil and natural gas marketplace in North America. It seeks to provide parity between the tax burdens and the exploration and development incentives that are provided by the U.S. government and similar burdens and benefits conferred upon Canadian companies by the Canadian and provincial governments.

This equalization is absolutely essential if the intent of the U.S.-Canada Free Trade Agreement is to be carried out successfully.

I wish to reiterate: This is second best policy. But it is vital policy if we are ever going to get the Canadians to eliminate their subsidies. If they have substantial subsidies and we have few, we have nothing to bargain with.

The skeptics might say that the U.S. industries could bring a countervailing duty case. Yet the Agreement replaces Article III judges with a politically appointed panel for binding, final determination of such cases. I am not sure an industry that has een suffering for the past four years can afford that kind of a political risk.

As a nation, we can't leave the question of whether we will have an oil and gas industry to five political appointees. And let's not forget that the U.S. only appoints half of the panelists. The Canadians have their own best interests operating here as well.

Taxes are one area of concern. There are regulatory issues that are also a concern, such as FERC order 256. I won't go into those issues today, but I intend to discuss them during the Energy Committee hearings scheduled for next week.

Mr. Chairman, I ask that a copy of a summary of the bill, as well as a copy of the bill itself, be included in the Record.

Thank you.

"U.S. Canada Free Trade Agreement
Oil and Natural Gas
Incentive Equalization Act of 1988"

- A bill to be introduced by Senator Domenici, cosponsored by Senators Boren, Nickels, Wallop, Johnston, Wallop, Breaux, Simpson, Bingaman, McClure.

- The findings and purposes of the bill are identical to the objectives set forth in the U.S.-Canada Free Trade Agreement, however the findings specifically mention oil and natural gas.

- Purpose of the bill is to conform the intent of the U.S.-Canada Free Trade Agreement with the realities of the oil and natural gas marketplace in North America; to provide parity between the tax burdens and the other exploration and development incentives provided in the United States and Canada.

- Specifically, the bill includes the following provisions:

  Expresses the intent of Congress that this Act be enacted prior to or at the same time as Congress considers the U.S.-Canada Free Trade Agreement.

- Repeals the Windfall Profits Tax to conform the U.S. Internal Revenue Code with the Canadian Income Tax Act, which repealed the Canadian Windfall Profits Tax in 1986.

- Improves tax treatment of geological, geophysical and surface casing costs to provide parity between the U.S. Internal Revenue Code and the Canadian Income Tax Act.

- Eliminates the Income Limitation Rule to assure parity between the U.S. Internal Revenue Code and the Canadian Income Tax Act.

- Reforms the percentage depletion allowance to provide incentives to offset resource allowances provided by the Canadian government.

- Repeals the Net Transfer Rule to provide a "catch up" incentive since the U.S. industry is required to pay substantially higher royalties than Canadian companies.

- Repeals the recapture provisions dealing with disposition of oil, gas, or geothermal property interests in order to provide "catch up" incentives for U.S. industry, which pays substantially higher royalties than Canadian companies.

- Provides a marginal production credit in order to offset exploration credits provided by the Canadian and provincial governments.

- Provides a crude oil production credit for maintaining economically marginal wells, a credit that offsets the cash payments made by the Canadian provincial government for exploration and development.

- Provides a crude oil and natural gas exploration and development credit to offset exploration and development credits provided by the Canadian and provincial governments.
- Eliminates intangible drilling costs as a preference item under the Alternative Minimum Tax in order to provide parity between U.S. Internal Revenue Code and the Canadian tax code.
- Establishes a procedure underwhich the Congress and the Administration work together to implement a plan designed to decrease imports whenever foreign oil dependence exceeds 50 percent.
- Repeals the taxable income test for percentage depletion in order to partially offset the resource allowances provided by the Canadian Government.

II

100TH CONGRESS
2D SESSION

S. 2096

Entitled the "United States-Canada Free Trade Agreement Oil and Natural Gas Incentive Equalization Act of 1988".

IN THE SENATE OF THE UNITED STATES

FEBRUARY 25 (legislative day, FEBRUARY 15), 1988

Mr. DOMENICI (for himself, Mr. BOREN, Mr. NICKLES, Mr. JOHNSTON, Mr. WALLOP, Mr. BREAUX, Mr. SIMPSON, Mr. BINGAMAN, and Mr. MCCLURE) introduced the following bill; which was read twice and referred to the Committee on Finance

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A BILL

Entitled the "United States-Canada Free Trade Agreement Oil and Natural Gas Incentive Equalization Act of 1988".

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SEC. 101. SHORT TITLE.

This Act may be cited as the "Canadian Free Trade Agreement Incentive Equalization Act".

SEC. 102. FINDINGS AND PURPOSES.

(a) FINDINGS.—The Congress finds that—

(1) the United States and Canada should strengthen the unique and enduring friendship between their two nations;

(2) the United States and Canada should promote productivity, full employment, and steady improvement of living standards for citizens employed in the oil and natural gas industries in their respective countries;

(3) the United States and Canada should create an expanded and secure market for oil and natural gas, goods and services produced in their territories;

(4) the United States and Canada should adopt clear and mutually advantageous rules governing their trade in all areas including oil and natural gas;

(5) the United States and Canada should ensure a predictable commercial environment for business planning and investment in the oil and natural gas industries;

(6) the United States and Canada should strengthen the competitiveness of United States and Canadian oil and natural gas firms in global markets;

(7) the United States and Canada reduce government-created trade distortions while preserving the two countries' flexibility to safeguard the public welfare;

(8) the United States and Canada should build on their mutual rights and obligations under the General

Agreement on Tariffs and Trade and other multilateral and bilateral instruments of cooperations;

(9) the United States and Canada should contribute to the harmonious development and expansion of world trade and to provide a catalyst to broader international cooperation; and

(10) that since the purposes and objectives of this Act are identical to those stated in the United States-Canada Free Trade Agreement except that they relate specifically to the oil and natural gas industry, it is the intent of Congress that this Act be considered, and passed prior to, or at the same time the Congress considers the Canada Free Trade Agreement.

SEC. 103. PURPOSE.

It is the purpose of this Act to conform the intent of the United States-Canada Free Trade Agreement with the realities of the oil and natural gas market place in North America; and to provide parity between tax burdens and exploration and development incentives provided by the United States Government and similar burdens and benefits conferred upon Canadian companies by the Canadian and provincial governments. This equalization is necessary if the intent of the United States-Canada Free Trade Agreement is to be successfully carried out.

SEC. 104. TABLE OF CONTENTS.

Sec. 105. Repeal windfall profits tax to conform the United States Internal Revenue Code with the Canadian Income Tax Act which repealed the Canadian windfall profits tax.

Sec. 106. Improved tax treatment of geological, geophysical, and surface casing costs to provide parity between the United States Internal Revenue Code and the Canadian Income Tax Act.

Sec. 107. Elimination of the net income limitation rule to provide parity between United States Internal Revenue Code and the Canadian Income Tax Code.

Sec. 108. Reforming percentage depletion to provide incentives in order to partially offset the resource allowances provided by the Canadian Government.

Sec. 109. Repeal of transfer rule to provide a "catch-up" incentive since the United States industry is required to pay substantially higher royalties than Canadian companies do, especially for exploration wells.

Sec. 110. Repeal of recapture provisions dealing with disposition of oil, gas, or geothermal property interests in order to provide "catch-up" incentives for United States industry that pays substantially higher royalties than Canadian companies, especially for exploration wells.

Sec. 111. Marginal production credit in order to offset exploration and development credits provided by the Canadian and provincial governments.

Sec. 112. Crude oil production credit for maintaining economically marginal wells in order to offset cash payments made by the Canadian Provincial Government for exploration and development.

Sec. 113. Crude oil and natural gas exploration and development credit to offset exploration credits provided by the Canadian and provincial governments.

Sec. 114. Removal of intangible drilling costs from the alternative minimum tax to provide parity between United States Internal Revenue Code and Canadian Tax Code.

Sec. 115. Establishes a procedure under which the Congress and the administration work together to implement a plan designed to decrease imports whenever foreign oil dependence exceeds 50 percent.

Sec. 116. Repealing the taxable income test for percentage depletion in order to partially offset the resource allowances provided by the Canadian Government.

SEC. 105. REPEAL WINDFALL PROFITS TAX TO CONFORM THE U.S. INTERNAL REVENUE CODE WITH THE CANADIAN INCOME TAX ACT WHICH REPEALED THE CANADIAN WINDFALL PROFITS TAX.

(a) Chapter 45 of the Internal Revenue Code of 1986 (referred to in this title as the "Code") is repealed.

(b)(1) Sections 6050C, 6076, 6232, 6430, and 7241 of the Code are repealed.

(2)(A) Subsections (a) of section 164 of the Code is amended by striking paragraph (4), and redesignating the subsequent paragraphs as paragraphs (4) and (5), respectively.

(B) The following provisions of the Code are each amended by striking "44, or 45" each place it appears and inserting "or 44":

(i) section 6211(a),

(ii) section 6211(b)(2),

(iii) section 6212(a),

(iv) section 6213(a),

(v) section 6213(g),

(vi) section 6214(c),

(vii) section 6214(d),

(viii) section 6161(b)(1),

(ix) section 6344(a)(1), and

(x) section 7422(e).

(C) Subsection (a) of section 6211 of the Code is amended by striking "44, and 45" and inserting "and 44".

(D) Subsection (b) of section 6211 of the Code is amended by striking paragraphs (5) and (6).

(E) Paragraph (1) of section 6212(b) of the Code is amended—

(i) by striking "chapter 44, or chapter 45" and inserting "or chapter 44", and

(ii) by striking "chapter 44, chapter 45, and this chapter" and inserting "chapter 44, and this chapter".

(F) Paragraph (1) of section 6212(c) of the Code is amended—

(i) by striking "of chapter 42 tax" and inserting "or of chapter 42 tax", and

(ii) by striking ", or of chapter 45 tax for the same taxable period".

(G) Subsection (e) of section 6302 of the Code is amended by striking "(1) For" and inserting "For", and by striking paragraph (2).

(H) Section 6501 of the Code is amended by striking subsection (m).

(I) Section 6511 of the Code is amended by striking subsection (h) and redesignating subsection (i) as subsection (h).

(J) Subsection (a) of section 6512 of the Code is amended—

(i) by striking "of tax imposed by chapter 41" and inserting "or of tax imposed by chapter 41", and

(ii) by striking ", or of tax imposed by chapter 45 for the same taxable period".

(K) Paragraph (1) of section 6512(b) of the Code is amended—

(i) by striking "of tax imposed by chapter 41" and inserting "or of tax imposed by chapter 41", and

(ii) by striking ", or of tax imposed by chapter 45 for the same taxable period".

(L) Section 6611 of the Code is amended by striking subsection (h) and redesignating subsections (i) and (j) as subsections (h) and (i), respectively.

(M) Subsection (d) of section 6724 of the Code is amended—

(i) by striking clause (i) in paragraph (1)(B) and redesignating clauses (ii) through (x) as clauses (i) through (ix), respectively, and

(ii) by striking subparagraphs (A) and (K) of paragraph (2) and redesignating subparagraphs (B), (C), (D), (E), (F), (G), (H), (I), (J), (L), (M), (N), (O), (P), (Q), (R), (S), and (T) as subparagraphs (A), (B), (C), (D), (E), (F), (G), (H), (I), (J), (K), (L), (M), (N), (O), (P), (Q), and (R), respectively.

(N) Subsection (a) of section 6862 of the Code is amended by striking "44, and 45" and inserting "and 44".

(O) Section 7512 of the Code is amended—

(i) by striking ", by chapter 33, or by section 4986" in subsections (a) and (b) and inserting "or chapter 33", and

(ii) by striking ", chapter 33, or section 4986" in subsections (b) and (c) and inserting "or chapter 33".

(3)(A) The table of contents of subtitle (D) of the Code is amended by striking the item relating to chapter 45.

(B) The table of contents of subpart B of part III of subchapter A of chapter 61 of the Code is amended by striking the item relating to section 6050C.

(C) The table of contents of part V of that subchapter is amended by striking the item relating to section 6076.

(D) The table of contents of subchapter C of chapter 63 of the Code is amended by striking the item relating to section 6232.

(E) The table of contents of subchapter B of chapter 65 of the Code is amended by striking the item relating to section 6430.

(F) The table of contents of part II of subchapter A of chapter 75 of the Code is amended by striking the item relating to section 7241.

(c) The amendments made by this section shall apply to crude oil removed from the premises after the date of the enactment of implementing legislation for the United States-Canada Free Trade Agreement.

SEC. 106. IMPROVED TAX TREATMENT OF GEOLOGICAL, GEOPHYSICAL, AND SURFACE CASING COSTS TO PROVIDE PARITY BETWEEN THE UNITED STATES INTERNAL REVENUE CODE AND THE CANADIAN INCOME TAX ACT.

(a) IN GENERAL.—Subsection (c) of section 263 of the Internal Revenue Code of 1986 (relating to intangible drilling and development costs in the case of oil and gas wells and geothermal wells) is amended by inserting before the last sentence the following new sentence: "In the case of oil and gas wells, the tax treatment which applies to the taxpayer's intangible drilling and development costs shall also apply to surface casing costs and to geological and geophysical costs for the purpose of ascertaining the existence, location, extent, or quality of any deposit of oil or gas within the United States (within the meaning of section 638(1)) or a possession of the United States (within the meaning of section 638(2))."

(b) CONFORMING AMENDMENT.—Subparagraph (B) of section 57(a)(2) of such Code is amended by adding at the end thereof the following new sentence:

> "For purposes of clause (i), the term 'intangible drilling and development costs' includes surface casing costs and geological and geophysical costs described in section 263(c).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to costs paid or incurred after the date of the enactment of this Act in taxable years ending after the enactment of the implementing legislation for the United States-Canada Free Trade Agreement.

SEC. 107. ELIMINATION OF THE NET INCOME LIMITATION RULE AS IT WOULD APPLY TO OIL AND GAS WELLS IN ORDER TO PROVIDE PARITY BETWEEN UNITED STATES INTERNAL REVENUE CODE AND THE CANADIAN INCOME TAX CODE.

(a) IN GENERAL.—The second sentence of subsection (a) of section 613 of the Internal Revenue Code of 1986 (relating to percentage depletion) is amended by striking out "Such allowance" and inserting in lieu thereof "Except in the case of an oil or gas well, such allowance".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to taxable years beginning after the date of the enactment of the implementing legislation for the United States-Canada Free Trade Agreement.

SEC. 108. REFORM OF PERCENTAGE DEPLETION TO PROVIDE INCENTIVES IN ORDER TO PARTIALLY OFFSET THE RESOURCE ALLOWANCES PROVIDED BY THE CANADIAN GOVERNMENT.

(a) IN GENERAL.—Paragraph (5) of section 613A(c) of the Internal Revenue Code of 1986 (defining applicable percentage) is amended to read as follows:

"(5) APPLICABLE PERCENTAGE.—For purposes of paragraph (1)—

"(A) IN GENERAL.—In the case of production during calendar years beginning after December 31, 1986—

"If the average annual removal price during the calendar year is:	The applicable percentage is:
Less than $10	30
$10 to $15	25
$15 to $20	20
Greater than $20	15.

"(B) AVERAGE ANNUAL REMOVAL PRICE.—For purposes of subparagraph (A), the average annual removal price for any calendar year shall be determined by dividing the taxpayer's aggregate production of domestic crude oil or natural gas during such calendar year by the aggregate amount for which such domestic crude oil or natural gas, as the case may be, was sold (determined after application of paragraphs (2), (3), and (4) of section 4988(c)) by the taxpayer."

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to production during calendar years beginning after the enactment of the implementing legislation for the United States-Canada Free Trade Agreement.

SEC. 109. REPEAL OF TRANSFER RULE TO PROVIDE A "CATCH-UP" INCENTIVE FOR UNITED STATES INDUSTRY THAT PAYS SUBSTANTIALLY HIGHER ROYALTIES THAN CANADIAN COMPANIES ON EXPLORATION WELLS.

(a) PERCENTAGE DEPLETION PERMITTED AFTER TRANSFER OF PROVEN PROPERTIES.—

(1) IN GENERAL.—Subsection (c) of section 613A of the Internal Revenue Code of 1986 (relating to limitations on percentage depletion in case of oil and gas wells) is amended by striking out paragraphs (9) and (10) and by redesignating paragraphs (11), (12), and (13) as paragraphs (9), (10), and (11), respectively.

(2) TECHNICAL AMENDMENT.—Paragraph (11) of section 613A(c) of such Code, as redesignated by subsection (a), is amended by striking out subparagraphs (C) and (D).

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to production after the date of the enactment of this Act in taxable years ending after the date of enactment of the implementing legislation for the United States-Canada Free Trade Agreement.

(b) EXEMPTION OF STRIPPER WELL OIL FROM WINDFALL PROFIT TAX TO APPLY AFTER TRANSFER.—

(1) IN GENERAL.—Subsection (g) of section 4994 of such Code (defining exempt stripper well oil) is amended to read as follows:

"(g) EXEMPT STRIPPER WELL OIL.—For purposes of this chapter, the term 'exempt stripper well oil' means any oil—

"(1) the producer of which is an independent producer (within the meaning of section 4992(b)(1)),

"(2) which is from a stripper well property within the meaning of the June 1979 energy regulations, and

"(3) which is attributable to the independent producer's working interest in the stripper well property.".

(2) EFFECTIVE DATE.—The amendment made by paragraph (1) shall apply to oil removed after the date of the enactment of the implementing legislation for the United States-Canada Free Trade Agreement.

SEC. 110. REPEAL OF RECAPTURE PROVISIONS DEALING WITH DISPOSITION OF OIL, GAS, OR GEOTHERMAL PROPERTY INTERESTS TO PROVIDE "CATCH-UP" INCENTIVE FOR UNITED STATES INDUSTRY THAT PAYS SUBSTANTIALLY HIGHER ROYALTIES THAN CANADIAN COMPANIES.

(a) IN GENERAL.—

(1) PROVISIONS IN EFFECT BEFORE TAX REFORM ACT OF 1986.—Section 1254 of the Internal Revenue Code of 1986 (relating to gain from disposition of interest in oil, gas, or geothermal property), as in effect before the amendments made by the Tax Reform Act of 1986, is hereby repealed.

(2) PROVISIONS IN EFFECT AFTER TAX REFORM ACT OF 1986.—Section 1254 of such Code, as in effect after the amendments made by the Tax Reform Act of 1986, is amended—

(A) by striking out "263, 616," in subsection (a)(1)(A)(i) and inserting in lieu thereof "616", and

(B) by adding at the end of subsection (a)(3) the following: "The term 'section 1254 property' does not include any oil, gas, or geothermal well."

(b) CONFORMING AMENDMENT.—

(1) Sections 59(e)(5)(A) and 291(b)(3) of such Code are each amended by striking out "263(c), 616(a)," and inserting in lieu thereof "616(a)".

(2) The heading for section 1254 of such Code, as amended by the Tax Reform Act of 1986, is amended by striking out "**OIL, GAS, GEOTHERMAL, OR OTHER**" and inserting in lieu thereof "**CERTAIN**".

(3) The item relating to section 1254 in the table of sections for part IV of subchapter P of chapter 1 of such Code is amended to read as follows:

"Sec. 1254. Gain from disposition of interest in certain mineral properties."

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to dispositions after the date of the enactment of the implementing legislation for the United States-Canada Free Trade Agreement.

SEC. 111. MARGINAL PRODUCTION CREDIT IN ORDER TO OFFSET EXPLORATION AND DEVELOPMENT CREDITS PROVIDED BY THE CANADIAN AND PROVINCIAL GOVERNMENTS.

(a) Subpart B of part IV of subchapter A of chapter 1 of the Code is amended by adding at the end thereof the following new section:

"SEC. 112. CRUDE OIL PRODUCTION CREDIT FOR MAINTAINING ECONOMICALLY MARGINAL WELLS IN ORDER TO OFFSET CASH EXPLORATION AND DEVELOPMENT BONUSES PROVIDED BY THE CANADIAN PROVINCIAL GOVERNMENTS.

"(a) ALLOWANCE OF CREDIT.—There shall be allowed as credit against the tax imposed by this chapter for the taxable year to the producer of eligible crude oil an amount equal to 10 percent of the qualified cost of each barrel of such oil (or fractional part thereof) produced during the taxable year.

"(b) QUALIFIED COST.—For purposes of this section, the term 'qualified cost' means, with respect to each barrel of eligible crude oil the sum of—

"(1) such barrel's pro rata share of—

"(A) the lease operating expenses (other than business overhead expenses) paid or incurred by the producer of such barrel during the taxable year in which such barrel was produced,

"(B) the amount allowed to such producer for such taxable year for depreciation under section 167 and 168 with respect to the property used in the production of such barrel,

"(C) the amount allowed to such producer for such taxable year for depletion under section 611 (but not in excess of the adjusted basis of the property), and

"(D) the business overhead expenses paid or incurred during such taxable year by such producer, plus

"(2) the amount of severance tax paid or incurred by such producer with respect to such barrel.

"(c) DEFINITIONS.—For purposes of this section—

"(1) ELIGIBLE CRUDE OIL.—The term 'eligible crude oil' means domestic crude oil which is—

"(A) from a stripper well property within the meaning of the June 1979 energy regulations, or

"(B) heavy oil, or

"(C) oil recovered through a tertiary recovery method.

"(2) OTHER DEFINITIONS.—

"(A) CRUDE OIL.—The term 'crude oil' has the meaning given to such term by the June 1979 energy regulations.

"(B) BARREL.—The term 'barrel' means 42 United States gallons.

"(C) DOMESTIC.—The term 'domestic' when used with respect to crude oil, means crude oil produced from a well located in the United States or in a possession of the United States.

"(D) UNITED STATES.—The term 'United States' has the meaning given to such term by paragraph (1) of section 638 (relating to Continental Shelf areas).

"(E) POSSESSION OF THE UNITED STATES.—The term 'possession of the United States' has the meaning given to such term by paragraph (2) of section 638.

"(F) HEAVY OIL.—The term 'heavy oil' means all crude oil which is produced from a property if crude oil produced and sold from such property during—

"(i) the last month before July 1979 in which crude oil was produced and sold from such property, or

"(ii) the taxable year had a weighted average gravity of 20 degrees API or less (corrected to 60 degrees Fahrenheit).

"(G) TERTIARY RECOVERY METHOD.—The term 'tertiary recovery method' means—

"(i) any method which is described in subparagraphs (1) through (9) of section 212.78(c) of the October 1979 energy regulations, or

"(ii) any other method to provide tertiary enhanced recovery which is approved by the Secretary for purposes of this section.

"(H) SEVERANCE TAX.—The term 'severance tax' means a tax imposed by a State or political subdivision thereof with respect to the extraction of crude oil.

"(I) ENERGY REGULATIONS.—

"(i) IN GENERAL.—The term 'energy regulations' means regulations prescribed under section 4(a) of the Energy Petroleum Allocation Act of 1973 (15 U.S.C. 753(a)).

"(ii) JUNE 1979 ENERGY REGULATIONS.—The June 1979 energy regulations shall be the terms of the energy regulations as such terms existed on June 1, 1979.

"(iii) OCTOBER 1979 ENERGY REGULATIONS.—The October 1979 energy regulations shall be the terms of the energy regulations as such terms existed on October 30, 1979.

"(iv) CONTINUED APPLICATION OF REGULATIONS AFTER DECONTROL.—Energy regulations shall be treated as continuing in effect without regard to decontrol of oil prices or any other termination of the application of such regulations.

"(d) LIMITATION BASED ON AMOUNT OF TAX.—

"(1) LIABILITY FOR TAX.—The credit allowable under subsection (a) for any taxable year shall not exceed the greater of—

"(A) the taxpayer's tentative minimum tax liability under section 55(b) for such taxable year determined without regard to this section or,

"(B) the excess of—

"(i) the taxpayer's regular tax liability for such taxable year (as defined in section 26(b)), over

"(ii) the sum of the credits allowable against such tax liability under part IV (other than section 43 and this section).

"(2) APPLICATION OF THE CREDIT.—Each of the following amounts shall be reduced by the full amount of the credit determined under paragraph (1):

"(A) the taxpayer's tentative minimum tax under section 55(b) for the taxable year, and

"(B) the taxpayer's regular tax liability (as defined in section 26(b)) reduced by the sum of the credits allowable under part IV (other than section 43 and this section).

If the amount of the credit determined under paragraph (1) exceeds the amount described in subparagraph (B) of paragraph (2), then the excess shall be deemed to be the adjusted net minimum tax for such taxable year for purposes of section 53.

"(3) CARRYBACK AND CARRYFORWARD OF UNUSED CREDIT.—

"(A) IN GENERAL.—If the amount of the credit allowed under subsection (a) for any taxable year exceeds the limitation under paragraph (1) for such taxable year (hereinafter in this paragraph referred to as the 'unused credit year'), such excess shall be—

"(i) an oil production credit carryback to each of the 5 taxable years preceding the unused credit year, and

"(ii) an oil production credit carryforward to each of the 3 taxable years following the unused credit year,

and shall be added to the amount allowable as a credit under subsection (a) for such years. If any portion of such excess is a carryback to a taxable year ending prior to January 1, 1987, this section shall be deemed to have been in effect for such taxable year for purposes of allowing such carryback as a credit under this section. The entire amount of the unused credit shall be carried to the earliest of the 8 taxable years to which such credit may be carried, and then to each of the other 7 taxable years to the extent that, because of the limitation contained in subparagraph (B), such unused credit may not be added for a prior taxable year to which such unused credit may be carried.

"(B) LIMITATIONS.—The amount of the unused credit which may be taken into account under subparagraph (A) for any succeeding taxable year shall not exceed the amount by which the limitation provided by paragraph (1) for such taxable year exceeds the sum of—

"(i) the credit allowable under subsection (a) for such taxable year, and

"(ii) the amounts which, by reason of this paragraph, are added to the amount allowable for such taxable year and which are attributable to taxable years preceding the unused credit year.

"(e) PASS-THRU IN THE CASE OF ESTATES AND TRUSTS.—Under regulations prescribed by the Secretary, rules similar to the rules of subsection (d) of section 52 shall apply.

"(f) TERMINATION OF CREDIT.—No credit shall be allowed under this section for any qualified cost paid or incurred in any taxable year beginning after the date which is three years after the date of the enactment of the National Energy Security Act of 1987.".

(b) The table of sections for subpart B of part IV of subchapter A of chapter 1 of the Code is amended by adding at the end thereof the following new item:

"Sec. 30. Crude oil production credit for maintaining marginally economic wells.".

(c) The amendments made by this section shall apply to oil produced in taxable years after the date of enactment of the implementing legislation for the United States-Canada Free Trade Agreement.

SEC. 113. CRUDE OIL AND NATURAL GAS EXPLORATION AND DEVELOPMENT CREDIT TO OFFSET EXPLORATION CREDITS PROVIDED BY THE CANADIAN AND PROVINCIAL GOVERNMENTS.

(a) Section 38(b) of the Code is amended—

(1) by striking "plus" at the end of paragraph (4),

(2) by striking the period at the end of paragraph (5) and inserting in lieu thereof ", plus", and

(3) by adding at the end thereof the following new paragraph:

"(6) the crude oil and natural gas exploration and development credit determined under section 43(a).".

(b) Subpart D of part IV of subchapter A of chapter 1 of the Code is amended by adding at the end thereof the following new section:

"SEC. 114. CRUDE OIL AND NATURAL GAS EXPLORATION AND DEVELOPMENT CREDIT.

"(a) GENERAL RULE.—For purposes of section 38, the crude oil and natural gas exploration and development credit determined under this section for any taxable year shall be an amount equal to the sum of—

"(1) 10 percent of so much of the taxpayer's qualified investment for the taxable year as does not exceed $10,000,000, plus

"(2) 5 percent of so much of such qualified investment for the taxable year as exceeds $10,000,000.

"(b) QUALIFIED INVESTMENT.—For purposes of this section, the term 'qualified investment' means amounts paid or incurred—

"(1) for the purpose of ascertaining the existence, location, extent, or quality of any crude oil or natural gas deposit, including core testing and drilling test wells,

"(2) for the purpose of developing a property on which there is a reservoir capable of commercial production and such amounts are paid or incurred in connection with activities which are intended to result in the recovery of crude oil or natural gas on such property, or

"(3) for the purpose of performing secondary or tertiary recovery technique on a well located in the

United States or in a possession of the United States as defined in section 638.

"(c) TERMINATION OF CREDIT.—

"(1) IN GENERAL.—Except as provided in paragraph (2), no credit shall be allowed under this section with respect to expenditures made in any taxable year beginning after the date which is three years after the date of the enactment of the National Energy Security Act of 1987.

"(2) BINDING COMMITMENTS.—Paragraph (1) shall not apply with respect to any qualified investment made pursuant to a binding contract entered into before the date determined under paragraph (1).".

(c) Section 38(c) of the Code is amended—

(1) by redesignating paragraph (4) as paragraph (5), and

(2) by inserting after paragraph (3) the following new paragraph:

"(4) EXPLORATION CREDIT MAY OFFSET MINIMUM TAX.—To the extent the credit under subsection (a) is attributable to the application of section 43, the limitation of paragraph (1) shall be the greater of—

"(A) the limitation as determined under paragraph (1), or

"(B) the taxpayer's tentative minimum tax for the taxable year.".

(d) The table of sections for subpart D of part IV of subchapter A of chapter 1 of the Code is amended by adding at the end thereof the following new item:

"Sec. 43. Crude oil and natural gas exploration and development credit.".

(e) The amendments made by this section shall apply to expenditures paid or incurred in taxable years after the date of enactment of the implementing legislation for the United States-Canada Free Trade Agreement.

SEC. 114. REMOVAL OF INTANGIBLE DRILLING COSTS FROM THE ALTERNATIVE MINIMUM TAX TO PROVIDE PARITY BETWEEN UNITED STATES INTERNAL REVENUE CODE AND CANADIAN TAX CODE.

(a) Establishment of Ceiling.—The President shall establish a National Oil Import Ceiling (referred to in this Act as the "ceiling level") which shall represent a ceiling level beyond which foreign crude and oil product imports as a share of United States oil consumption shall not rise.

(b) Level of Ceiling.—The ceiling level established under subsection (a) shall not exceed 50 percent of United States crude and oil product consumption for any annual period.

(c) Report.—(1) The President shall prepare and submit an annual report to Congress containing a national oil security projection (in this Act referred to as the "projection"), which shall contain a forecast of domestic oil and NGL demand and production, and imports of crude and oil product for the subsequent three years. The projection shall contain appropriate adjustments for expected price and production changes.

(2) The projection prepared pursuant to paragraph (1) shall be presented to Congress with the Budget. The President shall certify whether foreign crude and oil product imports will exceed the ceiling level for any year during the next three years.

The Congress shall have 10 continuous session days after submission of each projection to review the projection and make a determination whether the ceiling level will be violated within three years. Unless disapproved or modified by joint resolution, the Presidential certification shall be binding 10 session days after submitted to Congress.

(a) ENERGY PRODUCTION AND OIL SECURITY POLICY.—(1) Upon certification that the ceiling level will be exceeded, the President is required within 90 days to submit legislation to the Congress which shall serve as an Energy Production and Oil Security Policy (in this Act referred to as the "policy"). The policy if enacted shall prevent crude and product imports exceeding the National Oil Import Ceiling.

(2) The Energy Production and Oil Security Policy may include—

(A) oil import fee;

(B) energy conservation actions including improved fuel efficiency for automobiles;

(C) expansion of the Strategic Petroleum Reserves to maintain a 90-day cushion against projected oil import blockages; and

(D) production incentives for domestic oil and gas including tax and other incentives for stripper well production, offshore, frontier, and other oil produced with tertiary recovery techniques.

SEC. 115. IMPORT DEPENDENCE SAFETY NET IN ORDER TO REQUIRE CONGRESS AND THE ADMINISTRATION TO WORK TOGETHER TO ADDRESS IMPORTS WHENEVER DEPENDENCE EXCEEDS 50 PERCENT.

(a) Sections 57(a)(2) and 57(b) of the Code are hereby repealed.

(b) The repeal made by this section shall apply to costs paid or incurred after the date of the enactment of this Act, in taxable years ending after such date.

SEC. 116. REPEALING TAXABLE INCOME LIMITATION ON PERCENTAGE DEPLETION IN ORDER TO PARTIALLY OFFSET THE RESOURCE ALLOWANCES PROVIDED BY THE CANADIAN GOVERNMENT.

(a) In General.—Paragraph 613(A)(d)(1) is amended by deleting "65 percent" and inserting in lieu thereof "100 percent".

(b) Effective Date.—The amendments made by this section shall apply to the taxable years beginning after the date of the enactment of the implementing legislation for the United States-Canada Free Trade Agreement.

PREPARED STATEMENT OF CHARLES GENTRY

Mr. Chairman and Members of the Committee:

My name is Charles Gentry, attorney and partner in the Shank, Irwin, Conant, Lipshy & Casterline law firm of Dallas, Texas. I appear here today as Regional Vice-President of the Texas Independent Producers and Royalty Owners Association (TIPRO), which is composed of some 4,000 members with an interest in oil or gas in Texas. Many of our members compete directly with Canadian gas exports in both the California and Chicago markets and, therefore, have a direct concern with national policy relating to Canadian imports of natural gas, oil and petroleum products.

TIPRO understands and welcomes the long standing harmonious trade relationship that has existed between the United States and Canada. The benefits of this relationship for both countries are obvious. There is considerable merit, therefore, in the effort of the Administration to initiate workable trade principles in an agreement with Canada.

It is our contention, however, that trade policy applying to strategic commodities important to national defense objectives, such as petroleum and petroleum products, should be guided by standards apart from free trade objectives applying to other commodities. We believe, for example, that natural gas provided by a foreign source, no matter how friendly it might be should be subject to national security policy as opposed to agricultural goods that might fall under free trade objectives.

New England provides an interesting illustration for this problem. For several decades, the northeastern sector of our country has relied heavily on oil imports for its energy needs. This reliance has served short-term economic motives by temporarily supplying low cost energy. But strategically such reliance has left this important area of our country vulnerable to insecure foreign supply that has risen in cost during times of shortage.

Now this same vulnerablility arises with regard to natural gas as the result of the pending trade agreement with Canada. Both U.S. and Canadian gas producers have ample reserve supply to service New England and back out some of the imported oil supply now virtually monopolizing the area's energy market. Under provisions of the pending trade agreement, Canadian producers would have carte blanche authority to expand their exports to the United States to cover New England's needs. Domestic producers and their pipeline purchasers might well be blocked out of this market, leaving it hostage to foreign suppliers in the future. In that event, New England's over dependency on foreign sources for energy needs would simply be transferred from oil to gas.

In TIPRO's opinion, the trade agreement provisions relating to energy should have reflected more carefully the desired objective of maximizing utilization of U.S. petroleum reserves. The objective is partially impeded if foreign imports are allowed to come in freely and thereby displace domestic markets that could otherwise be served by domestic supply. Domestic producers must have optimum market opportunities to assure the economic ability necessary to maintain adequate exploration for and development of natural gas reserves.

Trends in U.S. natural gas production and Canadian imports in recent years, along with anticipated growth in imports in the near future, indicate that imports are winning the battle for marginal U.S. markets. This is happening during a period in which most experts believe excess U.S. producing capacity approximates 20 percent or more of production.

In the recession year of 1986, U.S. gas production dropped from 17.2 trillion cubic feet to 16.8 trillion, a reduction of 2.4 percent.1/ That year Canadian imports declined substantially to a total of 748 billion cubic feet. The following year, however, U.S. production recovered only 1.2 percent, while Canadian imports shot up 33.0 percent. In 1988, it is predicted that U.S. production will adjust upward by a modest 0.1 percent, while imports are anticipated to climb by 4.7 percent by one source and 7.1 percent by another.2/

The American Gas Association anticipates that by the mid-1990's gas imports from Canada will more than double, covering 10 percent of the U.S. markets.

These trends and predicted trends emphasize the fact that Canadian imports are enjoying an unequal opportunity to serve American consumers.

At the very least, we believe domestic gas producers should have an equal opportunity, in competition with imports, to serve home markets. This equality may be impossible to achieve under the energy provisions of the trade agreement, because current inequities in applicable tax law and energy regulations between the United States and Canada are not addressed. Unless enabling legislation finally approved by Congress addresses these inequities and authorizes that changes to secure a level playing field are acceptable once the trade agreement is finalized, the possibility of substantial growth in Canadian imports at the expense of U.S. production persists for the forseeable future.

Perhaps the most important of the inequities that must be addressed is the need to preserve the Federal Energy Regulatory Commission's Order 256, which attempts to equalize regulatory rate design between Canadian gas imports sold interstate in the United States and domestic production also sold interstate. While provisions of this order are arcane to the non-gas regulator, the bottom line is eminently clear. The order eliminates a substantial economic advantage formerly held by competing imports.

Work remains to be done to extend this element of fairness to California, Minnesota and New England gas markets. These markets are served by Canadian supply that also competes with domestic supply, but for institutional reasons is governed by the Economic Regulatory Administration (ERA) of the Department of Energy rather than FERC. The corrective measures of Order 256 have yet to be applied by the Administration to import sales governed by ERA. Unless this is accomplished prior to the finalization of the trade agreement, either through Administration action or through inclusion by Congress in enabling legislation, there is little hope it will be addressed successfully at a later date.

This is true of other inequities such as availability of tax exploration credits and matters involving U.S. pipelines with Canadian affiliates.

Senator Pete Domenici (R-NM) has recently introduced S. 2096 entitled "United States-Canada Free Trade Agreement Oil and Natural Gas Incentive Equalization Act of 1988," to this committee. This legislation provides incentives for the U.S. oil and gas producing industry which would tend to equalize the tax burdens and the exploration and development incentives now existing in the two countries.

TIPRO agrees with provisions of the bill that would improve tax treatment of geological, geophysical and surface casing costs; eliminate the net income limitation rule; reform percentage depletion; repeal the transfer rule; and institute several other credits to help equalize the playing field between Canadian producers and U.S. producers.

Another important aspect of the bill would call for a plan to decrease imports by Congress and the Administration when foreign oil dependence exceeds 50 percent. This excellent proposal is, of course, a derivation on a bill authored by the Chairman last year and supported by our Association.

In conclusion, we urge you as members of the Finance Committee to consider our concerns and to call upon those drafting the enabling legislation to help secure a level playing field for U.S. and Canadian petroleum producers. We strongly believe the long-range security interests of our nation require that domestic development of crude oil and natural gas, strategic commodities, should be enhanced rather than impeded or endangered by foreign trade agreements.

1/ Oil & Gas Journal, January 25,1988, Page 42.

2/ Wall Street Journal, February 24, 1988 issue, Page 28.

PREPARED STATEMENT OF ARTHUR GUNDERSHEIM

May 20, 1988

Senator George J. Mitchell
Senate Office Building
Washington, DC 20510

Dear Senator Mitchell:

When I testified on behalf of our union at the hearings on the Canadian Free Trade Agreement, you asked that I respond to a couple of questions in writing.

The first issue you raised was whether anything can be done in the implementing legislation to deal with problems in the textile and apparel area. My basic response is no, since the major issues of the Canadian Remission scheme and the quantity of textiles and apparel that receive duty free treatment, particularly its unfair distribution, cannot be changed through implementing legislation. I would say that if there is a way of making the process simpler and less expensive in dealing with issues of subsidy or dumping or other unfair trade practices, that should be most desired. Certainly, the binational members of the dispute settlement panel ought to be presidential appointees who receive advice and consent of the Senate. On the issues of Customs surveillance, same means has to be devised to assure greater control of what enters the U.S. from Canada. As we stated in our testimony, the potentials for fraud are very great.

One thing we strongly object to would be any inclusion of products assembled under Section 807 as being defined as U.S. products under this agreement.

The second question you raised was the degree of consultation for the Trade Representative's office. In fact, I would say that Ambassador Peter Murphy did an excellent job in that respect. (I should say, parenthetically, that I have known Peter Murphy for many years and our personal relationship may have helped the consulation process.) However, at the end when the major decisions were made, the process broke down. The decision to give major powers to the binational dispute settlement panels made by Treasury-Secretary Baker and the final quantities of textile and apparel included under the tariff rate quota came as complete surprises. I must say, in the seven years of the Reagan Administration, the Trade Representative's office has been dramatically less responsive to private sector advise than prior administrations. This, in part, was true of the general outlines of the Canadian Free Trade Agreement.

The whole process, however, and the subsequent testimony now that the agreement has been completed, strongly indicates that the fast track procedure used to approve trade agreements is a major mistake. As is clearly obvious from the Senate's ability to deal with problems in the INF treaty, I do not understand why the same opportunities do not exist for trade agreements. It is our strong belief that the Congress needs greater authority to modify trade agreements than the fast track process allows.

If there are any further concerns you would like me to address, I would be happy to do so.

Sincerely,

Arthur Gundersheim
Assistant to the President

AG:wrj

Statement of Robert A. Hiney
Executive Vice President
Marketing and Development
New York Power Authority

Mr. Chairman and Members of the Committee:

My name is Robert Hiney, and I am Executive Vice President, Marketing and Development, of the New York Power Authority. In that capacity, I am responsible for the planning of future power supplies for the Power Authority. This includes negotiating power contracts with other utilities, both domestic and Canadian.

I appreciate the opportunity to present testimony on behalf of the Power Authority on a matter which we consider most important to electricity consumers throughout New York State and the rest of the country.

The New York Power Authority is the largest non-federal public power agency in the United States. We provide about one-third of New York State's electricity.

Our mandate, both statutory and market driven, is to provide the cheapest possible power to our customers in the State of New York and in neighboring states. Those customers include basic industries, governmental agencies such as the City of New York and its subway system, municipal and cooperative electric systems and investor-owned electric utilities throughout the State which purchase Power Authority electricity for the benefit of their customers.

The Power Authority owns two major hydroelectric generating projects, two nuclear plants, a pumped-storage hydro project, a gas-and-oil fired plant and five small hydro projects. Our projects generated approximately 35.8 billion kilowatt hours of electrical energy in 1987. In addition, the Power Authority owns an extensive high voltage transmission network, including approximately 1400 circuit miles of transmission lines. In 1987, we purchased 8.4 billion kilowatt hours of electricity from Canadian utilities pursuant to a series of contractual agreements which I will describe briefly in a few minutes.

The Power Authority has no monopoly franchise area; we are a fully competitive utility. We are therefore particularly concerned about the cost of electricity which we generate and purchase since we have to undersell our competition wherever we provide power. In addition, we have a particularly strong incentive from our legislature and our customers to do everything possible to provide low cost power. Some areas of New York State have electricity rates which are among the highest in the nation, and businesses seeking lower costs will look elsewhere, including overseas, if steps are not taken to reduce energy costs.

By virtue of the location of our two major hydroelectric generating projects, the Power Authority has a long-standing relationship with Canadian utilities. At Niagara Falls, we share the waters of the Niagara River, pursuant to international treaty; at our St. Lawrence-FDR Project, the international border passes through the center of the power dam. Since the early 1960s, the Power Authority and Ontario Hydro have coordinated the operation of the two systems for interchange of power at the Niagara and St. Lawrence-FDR interconnections, as well as for the use of generating equipment of either system by the other in order to make optimum use of all available water at all times.

In 1974, relationships with our Canadian partners began to broaden. In that year, we concluded a contract with Hydro-Quebec under which it agreed to make available 800 megawatts of firm "diversity" power and associated energy to the Power Authority during the warm weather months of April through October. It is at this time that New York's system needs additional power due to higher peak loads, and surplus capacity is available to the Canadians, since their greatest demand is in the winter. As part of this contract, we constructed a high capacity transmission interconnection between the Quebec border and Central New York which was completed in 1978.

We have purchased surplus energy from Ontario Hydro since the mid-1960s, and in 1978 began buying substantial quantities of non-firm energy from Hydro-Quebec. These purchases provide us with electricity on an "as available" basis which we obtain only when it is cheaper than that available from existing sources in New York State.

Finally, we have most recently signed a memorandum of agreement with Hydro-Quebec for the provision of firm power -- 1,000 megawatts -- which is our first year-round firm capacity purchase contract. This contract will replace current surplus energy purchases with firm capacity and energy which can be counted upon for capacity needs. Since 1978, New York State industrial, commercial and residential consumers have saved more than $600 million as a result of Power Authority purchases of Hydro-Quebec power and energy alone. Additional savings have been realized from purchases of power from Ontario Hydro. At the same time, it should be recognized that Canadian power represents only a small fraction of New York's electrical energy needs. In 1987, 11 percent of our State's electric energy came from Canada; most of this was non-firm, surplus energy which reduced our costs but was not required to meet capacity needs within the State.

The focus of today's hearing is the potential effect of the Free Trade Agreement (FTA) on the consumers and industries of the United States. As it relates to the subject of electric energy, and particularly to the New York Power Authority and its mission and activities, my answer is that the impact of the agreement will be positive, and we support its implementation. Let me outline my reasons for that conclusion.

At the outset, let me point out that the Free Trade Agreement, as we understand it (in the absence of detailed implementing statutory language) does not materially change the status quo regarding electricity trade. Trade in electricity between the United States and Canada has historically been unencumbered by artificial barriers; instead, it has focused on the most economic dispatch of available sources of electricity generation.

The Canadian power sellers and the American buyers have to date operated on a purely market driven basis, and the FTA not only ensures that these market considerations will prevail, it provides additional protections.

A comparison of the current status to prospective conditions under the FTA suggests that under the new agreement there would be substantial protections for purchases of Canadian electricity as to price, regulatory actions, taxes, and other potentially discriminatory treatment.

The FTA will provide:

1) Explicit recognition that prohibits quantitative restriction, minimum export pricing and minimum import pricing. FTA article 902(2). Canada will thus waive the current "least cost alternative" minimum pricing mechanism;

2) Both parties to waive any export taxes, duties or charges, unless the same tax, duty or charge is levied on energy goods destined for domestic consumption. FTA Article 903;

3) The parties to agree to specific limits on any export restrictions, even if such restrictions are GATT justified. FTA Article 904; and

4) The parties agree to consultations at the request of either party if an "energy regulatory action (including NEB and ERA decisions) would directly result in discrimination against its energy goods or persons inconsistent with the principles of this Agreement." FTA Article 905.

The large-scale hydropower currently being developed in Canada enjoys a significant cost advantage over other large-scale generating options. This advantage is the essence of the cost disparity between power generated by U.S. domestic utilities and that which is generated in Canada. This is true with or without the Free Trade Agreement.

It makes good sense from an environmental standpoint to maximize use of those existing hydro resources which can be economically developed, wherever located, before turning to combustion of fossil fuels. Further, the use of this renewable resource helps conserve the world's non-renewable energy reserves. For example, purchases of Canadian hydropower for the Northeast will principally displace imported oil and natural gas-fired generation. In New York State about half of the generating capacity is oil-dependent. In 1986, even with a helpful assist from Canadian energy, the state had to rely on oil and natural gas for 38 percent of its electricity production.

In fact, the General Accounting Office (GAO), studying the issue of Canadian electricity imports in 1987 found that:

> To the extent that the proposals would result in reduced Canadian electricity imports, U.S. utilities may start using more imported oil. This would add to current security concerns over the level of U.S. reliance on imported oil and could increase the price of electricity to consumers, primarily in Northeastern states which rely to a large degree on oil-fired generation plants. [1]

We believe that to the extent that the security of imports of Canadian power is enhanced by the FTA, it is a positive development for American industry and consumers.

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[1] U.S. General Accounting Office, Canadian Power Imports: Issues Related to Competitiveness, (Washington, D.C.: U.S. GAO, October 1987).

I do not wish to leave the impression that this is only a Northeastern issue. Canadian electricity reaches the Midwest, the North Central U.S., the Pacific Northwest, and the Far West.

As I have noted, however, Canadian electricity is especially important in the Northeast in reducing oil dependence and lowering some of the nation's highest electricity bills. Quebec, Ontario and New Brunswick supplied nearly 28 billion kilowatt hours of lower-cost electricity to this region in 1987 -- equivalent to more than 46.5 million barrels of imported oil.

This region is important in providing services and in the production of machinery, electrical equipment, instruments, transportation equipment, fabricated metal, and paper, as well as in printing and publishing.

Much has been said in recent months concerning the importance of enhancing the competitiveness of American industry. The free exchange of electricity, negotiated to the satisfaction of the trading partners, plays an important role in enhancing competitiveness through more efficient allocation of resources.

The price of energy in general, and electricity in particular, is of key importance in the competitive pricing of U.S. products. It must be considered along with the cost of capital, labor and natural resources. The cost of electricity is especially crucial since it is increasingly becoming the energy source of choice in powering our industrial and commercial sectors. Our competitive posture is strengthened when we are able to reduce these costs per unit of output through increased efficiencies.

Finally, let me add that while we desire to keep the Canadian option, we also encourage fuel diversity and do not wish to become overly dependent on Canadian energy sources. When our new 1000 megawatt firm power contract goes into effect, New York will be purchasing only 1,800 megawatts of its annual capacity needs from Canadian sources, which only amounts to 5 percent of the State's projected capacity resources in 1996. In that year New York's capacity mix will include about 4800 megawatts of coal fired generating capacity.

ADDITIONAL COMMENTS OF THE NEW YORK POWER AUTHORITY

The following information is provided to supplement and clarify the testimony which was presented to the Committee on Finance pertaining to the U.S./Canada Free Trade Agreement on April 13, 1988.

There was some discussion as to how the price for the 1000 MW of power to be purchased by the New York Power Authority from Hydro-Quebec will be determined. The price for the 1000MW of firm power is stated in the terms of the contract.

The contract will include a fixed base price for the capacity and energy expressed in 1985 U.S. dollars. The price is subject to adjustments using agreed upon indices which track general inflation, construction costs, and interest rates in the U.S. When the contract starts, the capacity charge will be frozen and the inflation adjustment will apply only to the energy portion of the price. The price is not tied to the price of oil or any other fuel. The base price at the international border is 4.9 cents per KWH in 1985 dollars, and we project it will be about 7.4 cents per KWH in 1995, the first year of the contract term. The price will not be subject to change as a result of governmental action after the necessary regulatory approvals are obtained.

The second area of discussion that needs some clarification is the nature of the relationship between the quantity of U.S. coal which is imported by Ontario Hydro and the quantity of electricity which is exported to U.S. markets.

Ontario Hydro produces electricity primarily from hydroelectric, nuclear and coal plants in Ontario, and dispatches these plants economically to minimize the cost of electricity to its domestic customer. Thus, its surplus electricty sold to the U.S. is produced primarily from its coal fired plants, which have operating costs higher than those of hydro of nuclear plants. Therefore, any reduction in electricity exports to the U.S. would reduce its need for coal, which it imports from the U.S. These energy exchanges benefit the coal industry as well as electricity consuemrs in the U.S. Last year Ontario Hydro exported 6.5 billion KWH, about 5.4 billion KWH of which was sold in New York. I understand Ontario Hydro has decided to invest about three billion dollars in scrubbers for its existing coal plants which will enable continued use of these plants to meet their growing electricity needs and enable continued surplus electricity sales to the U.S.

Statement of Robert A. Hiney
Executive Vice President
Marketing and Development
New York Power Authority

I am Executive Vice President, Marketing and Development, of the New York Power Authority, the largest non-federal public power agency in the United States. We provide about one-third of New York State's electricity. In that capacity, I am responsible for the planning of future power supplies for the Power Authority. This includes negotiating power contracts with other utilities, both domestic and Canadian.

Our mandate, both statutory and market driven, is to provide the cheapest possible power to our customers in the State of New York. By virtue of the location of our two major hydroelectric generating projects, the Power Authority has a long-standing relationship with Canadian utilities.

Since 1978, New York State industrial, commercial and residential consumers have saved more than $600 million as a result of Power Authority purchases of Hydro-Quebec power and energy alone. Additional savings have been realized from purchases of power from Ontario Hydro. At the same time, it should be recognized that Canadian power represents only a smal fraction of New York's electrical energy needs. In 1987, 11 percent of our State's electric energy came from Canada; most of this was non-firm, surplus energy which reduced our costs but was not required to meet capacity needs within the State.

The focus of today's hearing is the potential effect of the Free Trade Agreement (FTA) on the consumers and industries of the United States. As it relates to the subject of electric energy, and particularly to the New York Power Authority and its mission and activities, my answer is that the impact of the agreement will be positive, and we support its implementation.

Trade in electricity between the United States and Canada has historically been unencumbered by artificial barriers; instead, it has focused on the most economic dispatch of available resources of electricity generation.

The Canadian power sellers and the American buyers have to date operated on a purely market driven basis, and the FTA not only ensures that these market considerations will prevail, it provides additional protections. A comparison of the current status to prospective conditions under the FTA suggests that under the new agreement there would be substantial protections for purchases of Canadian electricity as to price, regulatory actions, taxes, and other potentially discriminatory treatment.

The large-scale hydropower currently being developed in Canada enjoys a significant cost advantage over other large-scale generating operations. This advantage is the essence of the cost disparity between power generated by U.S. utilities and that generated in Canada. This is true with or without the Free Trade Agreement. Also, it makes good sense from an environmental standpoint to maximize use of those existing hydro resources which can be economically developed, wherever located, before turning to combustion of fossil fuels.

Much has been said in recent months concerning the importance of enhancing the competitiveness of American industry. The free exchange of electricity, negotiated to the satisfaction of the trading partners, plays an important role in enhancing competitiveness through more efficient allocation of resources.

The cost of electricity is especially crucial since it is increasingly becoming the energy source of choice in powering our industrial and commercial sectors. Our competitive posture is strengthened when we are able to reduce these costs per unit of output through increased efficiencies.

Statement of Senator David K. Karnes on the Canada-United States Free Trade Agreement before the Senate Committee on Finance

April 21, 1988

Mr. Chairman, I thank the Committee for allowing me to testify today on the Canada-United States Free Trade Agreement. As you know, President Reagan signed this agreement on January 2nd. The agreement has far-reaching implications for almost all sectors of the U.S. economy in that the United States and Canada trade more goods and services than any other trading partners in the world. This trade was valued at more than $150 billion in 1986. The centerpiece of the agreement is the planned elimination of all bilateral tariffs on goods within a ten-year time frame. Other provisions focus on reducing non-tariff barriers, establishing rules for conducting trade in services, establishing rules for undertaking investment, and resolving trade disputes.

While I generally favor broadening trade opportunities and reducing barriers to expand international trade, I have not made any final judgment about this agreement. I want to have a chance to review the final text of the implementing legislation, the drafting of which is the responsibility of this committee along with the Administration and the House Ways and Means Committee, before I make such a judgment. The fact that this implementing legislation is subject to "fast-track" procedures, and is not subject to amendment, makes it very important that each Senator carefully review the text of the legislation. It is with the question of the drafting of the implementing legislation in mind that I address you today.

First, I would like to make some general observations about the agreement. While the agreement makes significant progress toward eliminating barriers to trade between the United States and Canada, it is not a free-trade agreement in the fullest sense of the term. Many non-tariff barriers and subsidies will remain in effect under this agreement. Also, it is important to remember that this agreement touches upon almost all aspects of our trade relationship with Canada. Obviously, under negotiations of this sort, different sectors of our economy are touched by the agreement in different ways. Nevertheless, it is important to work to see that no one sector of the economy receives unfair treatment just to facilitate progress in other areas. While some give and take is inevitable, it is not appropriate that a single sector of the economy be forced to bear an undue burden.

Mr. Chairman, I am particularly concerned about the effect this agreement will have on the agricultural sector of our economy. Agricultural trade between the United States and Canada amounts to approximately 3 percent of the total volume of trade. Even if farm machinery, fertilizers and pesticides were included, agriculture's share would be under 10 percent of the total volume of trade. In my view, U.S. negotiators treated agricultural concerns as less important than other aspects of the negotiations because of this relatively small volume of trade. The result has been that those in agriculture feel the agreement leaves Canada in a better position with regard to agricultural trade. In general terms, they feel that while American tariff-based barriers are eliminated by the agreement, Canadian non-tariff barriers and subsidies remain intact. I would particularly like to discuss the views of various agricultural producers about their specific concerns with the U.S.-Canada Free Trade Agreement. In several instances, it may be possible to address their concerns in the course of the drafting of the implementing legislation. Thus, I hope the committee will give these concerns careful consideration.

American wheat producers believe the Canadians have more to gain from the agreement than U.S. producers. Canada has prevented the importation of wheat through an import licensing system that grants licenses only if a product is not domestically available. Also, the Canadians retain rail rate subsidies on exported wheat that amount to $18 per metric ton. Finally, the Canadians retain a two-tiered price structure on wheat, which encourages wheat exports. The U.S. allows Canadian wheat to enter the country only upon the payment of a twenty-one-cents-per-bushel tariff. Under the agreement, Canada will not have to eliminate its import licensing requirements until domestic subsidy levels on wheat are at equivalent levels, based on a complex formula. While Canada has announced it will end its two-tiered price structure, a timetable has not yet been given. The rail rate subsidies will be eliminated only for wheat exports shipped out of western ports. The agreement, of course, will phase out the U.S. tariff. None of the Canadian barriers or subsidies are completely eliminated, while the U.S. tariff will be eliminated.

Wheat producers would like the committee to keep the following recommendations in mind as it drafts the implementing legislation. First, they would like to see the committee clarify language concerning future implementation of Section 22 of the Agricultural Adjustment Act of 1933 under the agreement, to establish October 4, 1987, as the effective date for defining existing wheat programs, to define the term "substantial change" as it is used in the agreement, and to provide flexible definitions for the terms "increase significantly" and "as a result of" with regard to the same provision of law. Wheat producers would also like to see statements urging the Canadian Wheat Board to maintain Canadian wheat exports to the United States at current levels. Finally, wheat producers would like to see assurances that the remaining transportation subsidies be calculated in determining the pledge that neither party will export wheat at less than the acquisition cost. I should point out to the committee that corn producers share many of the same concerns as the wheat producers.

U.S. egg producers are concerned that while the agreement eliminates tariffs over a ten-year period, the Canadians will be allowed to retain their import quota system. These producers do not understand how a "free trade agreement" will allow such a quota system to remain. The Canadians have agreed to increase the level of imports they will accept, but U.S. producers fear that the elimination of the tariff will encourage Canadian imports. Thus, U.S. egg producers hope that the Administration will work aggressively to convince the Canadians to eliminate their quota system on imported eggs.

U.S. dry bean producers are concerned that the free trade agreement will not eliminate two Canadian subsidies. The first of these subsidies is the so-called tri-partite program. This program consists of an agreement between Canadian dry bean producers, the government of Ontario Province, and the Canadian federal government to subsidize dry bean production. U.S. producers are concerned this program will cause over-production in Canada and that the Canadians will dump the surplus on the world market. The second of these subsidies is the continuation of the rail transportation subsidy for exports shipped through eastern ports, which is referred to in my earlier discussion about trade in wheat. U.S. dry bean producers would like to see the Administration move aggressively to end these subsidies before the tariff is eliminated.

Mr. Chairman, while agricultural trade between the United States and Canada constitutes only a small portion of the total trade between the two countries, this agreement will still have a tremendous impact on the people of Nebraska. I want to ensure that this committee will not discount questions about agricultural trade in order to obtain concessions in other areas. The committee has an opportunity to address the concerns of the agricultural sector to some extent in the course of drafting the implementing legislation.

While I will cast my vote on this agreement based on its merits as a complete package, I cannot justify imposing an unfair burden on a particular sector of the economy for the sake of the agreement. If we are going to have a free trade arrangement with Canada, we must work to eliminate market distortions other than just tariffs, including subsidies and non-tariff barriers. I hope the committee will deliver a strong message to the Administration and, ultimately, the Canadians that we want to halt these other market distorting practices. Again, Mr. Chairman, I thank the committee for allowing me the opportunity to testify here today.

STATEMENT OF
WILLIAM T. McCORMICK, JR.
ON BEHALF OF THE AMERICAN GAS ASSOCIATION
BEFORE THE
FINANCE COMMITTEE OF THE
UNITED STATES SENATE
ON THE
CANADA - U.S. FREE TRADE AGREEMENT
April 13, 1988

STATEMENT OF INTEREST

I am William McCormick, Chairman and CEO of CMS Energy Corporation, the parent company of Consumers Power Co. My company provides natural gas and/or electricity to nearly six million of the State of Michigan's nine million residents. As a sponsor of the Midland Cogeneration Venture, a planned, highly efficient combined cycle power plant in Midland, Michigan, we are very interested in long-term energy trade with Canada. In fact, we have already tapped the Canadian market for some long-term natural gas supplies to fuel this 1,370 megawatt (MW) facility, although much of the supply commitments will come from domestic gas producers.

Today, however, I am appearing on behalf of the American Gas Association (A.G.A.). A.G.A. is a national trade association with some 250 natural gas distribution and transmission company members. These companies serve 84.3% of the gas utility customers in the U.S. and have a long standing interest in natural gas supply security.

In this regard, I was Co-chairman of the A.G.A./Canadian Gas Association Joint Task Force on Long-Term U.S.- Canadian Natural Gas Trade. This Task Force began meeting in the autumn of 1986, to develop some common policies on long-term natural gas trade, which they could recommend to the people and the governments of their two countries. In September 1987, the Task Force published its report, Long-Term U.S/Canadian Natural Gas Trade, which specifically endorsed a bilateral treaty dealing with natural gas trade between our two countries. The Task Force report said:

> Representatives of the natural gas industry on both sides of the border recognize their own primary responsibilities for the development of gas supplies and for the working out of financial and operational arrangements for production and delivery of gas. They recognize also that their efforts will be ineffective without the support of governments in both countries, as expressed formally in a bilateral energy trade treaty.
> Such a treaty could be negotiated separately or could be embodied in a broader Canada-U.S. trade treaty, such as proposed in the current free trade negotiations between the two countries. The important thing is that an agreement on natural gas trade should be concluded as quickly as possible -- ideally within the next 12 months.[1]

Therefore, I am here today to support the U.S./Canadian Free Trade Agreement not only as the Chairman and CEO of a diversified energy business and as a U.S. energy distributor, but also on behalf of the broad interests of A.G.A.'s national membership and the international membership of the U.S./Canadian Joint Task Force. I firmly believe that the energy sections of the Free Trade Agreement

will benefit consumers, producers, industry and electrical customers, as well as natural gas distributors and pipelines in both countries.

THE FTA HAS DEFINITE NATIONAL SECURITY BENEFITS

The Free Trade Agreement greatly benefits U.S. national security. First, it protects natural gas imports from sudden disruptions or politically motivated price increases. Second, it allows the U.S. to rely on some Canadian gas to displace less secure oil imports from the unstable Middle East.

On the first point, the FTA protects U.S./Canadian energy imports from the threat of sudden cut-offs. More specifically, Article 904 requires that if Canada restricts natural gas imports to the U.S., it has to similarly restrict its domestic gas consumption. Naturally, the U.S. is similarly bound. Although Article 904 does not apply "in times of war or other emergency in international relations"2/ it provides substantial supply security, in contrast to Middle East oil suppliers who have in the past attempted to influence U.S. policy by threatening to cut-off oil supplies in order to gain their political ends.

On the second point, the U.S. has a clear policy of displacing imported oil with natural gas. For example, the U.S. Department of Energy's report to the President, Energy Security, stressed the importance of substituting natural gas for imported oil.3/ The conclusions in this report were also echoed by the National Defense Council Foundation (NDCF), which published an issue alert, Will the Future Be Reflected In the Past? -- The DOE Energy Security Report One Year Later.4/ NDCF makes strong national security arguments that the U.S. should reduce its reliance on imported oil, in part, by displacing Middle East oil with North American natural gas.

A.G.A. has estimated that nationwide, natural gas could displace 350,000 barrels of oil a day immediately.5/ After that, we estimate that gas could displace 720,000 barrels a day within one year, and 1,700,000 barrels a day within five years. The following is a concrete example of how natural gas can displace oil in just one section of the U.S. -- the Northeastern states.

OIL DISPLACEMENT EXAMPLE:

> In 1986, electric utilities in the Northeast used 380 thousand barrels/day of oil -- roughly 56 percent of all the U.S. oil consumed by U.S. electric power plants and seven percent of total U.S. net oil imports. If these plants were converted to natural gas, they would require an additional 814 billion cubic feet (Bcf) of gas per year to be delivered to the Northeast. Because the present infrastructure needs to be expanded dramatically to serve this load, the U.S. Federal Energy Regulatory Commission is even now considering some 31 different projects to serve the Northeast. It is significant that these projects would draw their gas from both domestic and Canadian sources.

Increased natural gas use surely has overriding national policy benefits. In 1987, imported oil made up about 40 percent of the nation's oil consumption. To the extent that U.S. consumers can switch to natural gas (whether from our own production or from a secure trading partner like Canada) we enhance our national security, improve our economic health/balance of payments, and even create a cleaner environment for ourselves (discussed below).

ENHANCING U.S. GAS SUPPLY SECURITY

North American natural gas supplies are both secure and abundant. Because oil resources are being depleted at a much quicker rate than natural gas, the hydrocarbon resource base is becoming increasingly gas prone. The Potential Gas Committee has estimated that, with currently foreseeable technology and economics, there are 620 trillion cubic feet (Tcf) of potential conventional resources in the lower-48 states alone, with an additional 118.8 Tcf of gas resources in Alaska. When 159 Tcf of proved reserves are added to this number, the lower-48 states has the equivalent of about 50 years of conventional supply at 1986 production levels.[6] Canada has proved reserves of 97 Tcf and a total of 426 Tcf of potential and proved reserves.[7] The combined resources of the U.S. and Canada -- an extraordinary 256 Tcf of proved reserves and 940 Tcf of proved and potential reserves -- are more than adequate to supply traditional and new markets, especially high-efficiency energy technologies that can lower the cost of U.S. goods and services.

ECONOMIC BENEFITS OF FREE TRADE AGREEMENT

Providing additional, reliable supplies of natural gas from Canada can also lower the cost of natural gas to U.S. energy users -- both individuals and businesses. These lower costs can aid in making U.S. products more competitive in world markets (by lowering energy costs over time), using natural gas has other balance-of-trade benefits. Imported oil is 50 percent more expensive than natural gas at the border. Oil displacement of the magnitudes discussed earlier, would reduce the U.S. trade deficit by more than $200 million per month immediately, and up to $1 billion per month within five years. These trade benefits should not be overlooked.

THE ENVIRONMENTAL BENEFITS OF INCREASING NATURAL GAS USAGE

Natural gas is an environmentally attractive fuel, whose use can reduce ozone and carbon monoxide pollution. Compared to other fossil fuels, natural gas emits far fewer pollutants, including carbon monoxide, nitrogen oxide, sulfur dioxide, and hydrocarbons, as well as ash, sludge, and solid waste. These pollutants can be reduced quickly since many existing emitters already have gas service and can convert easily. Using natural gas often has lower capital and operating costs too, so that the cost of reducing air pollution can be lower. Naturally, these lower compliance costs translate into financial savings for U.S. industries that are facing stiff foreign competition, at the same time that environmental deadlines, such as the nonattainment provisions of the Clean Air Act, would otherwise increase an industry's pollution control costs.

We could give numerous examples of ways to use natural gas to reduce pollutants.

1. A combined cycle gas power plant uses a gas-fueled turbine, a steam turbine and a heat recovery steam generator to generate electricity. Such units emit less than 0.3 percent of the sulfur dioxide and 57

percent of the nitrogen dioxide of comparable coal fired units, nor do they produce ash or sludge. They can be built quickly (in one to two years vs. eight to fifteen for coal or nuclear units) and are extremely cost effective. The relatively low capital cost of combined cycle units is approximately $500 per kilowatt, about 1/3 the cost of new coal units.

2. Gas-fired cogeneration systems that generate electricity and steam to run industrial processes have similar environmental, energy and cost efficiencies.

3. "Select use" of natural gas allows a plant operator to get immediate emission reductions by using natural gas with coal, in the same or even in different units. The operator's pollution control costs can be much less than installing a "scrubber" or other conventional pollution control device.

4. Besides reducing oil imports, using natural gas as a primary vehicular fuel, or as a fuel additive can reduce carbon monoxide emissions by as much as 99 percent, nitrogen oxides by 65 percent, and reactive hydrocarbons by 85 percent. Reductions of this magnitude could be the key to clean air in cities where air pollution has been an intractable problem up to now.

Before regulators and plant operators commit themselves to these options, however, they need to be assured that there will be adequate natural gas supplies in the future. Although the U.S. resources base is large enough to sustain this growth, the Free Trade Agreement provides an important extra level of supply security.

BENEFITS FOR DOMESTIC GAS PRODUCTION

Some U.S. producers perceive Canadian gas imports as a competitive threat, which could disadvantage them. For several reasons, however, they have little to fear and much to gain from the Agreement.

First, they have little to fear because the Free Trade Agreement will have no effect on current gas trade between the U.S. and Canada or on current drilling in the U.S. The U.S. presently has a surplus of natural gas and it is the existence of these excess inventories -- not Canadian gas -- that has depressed the rate of gas exploration and production in the U.S. Excess U.S. natural gas deliverability (generally known as the gas "bubble") was 2.2. Tcf in 1987.[8] In calendar year 1988, however, A.G.A. projects that the bubble will shrink to 1.1 Tcf and that it will be essentially zero by 1990 (full year estimate). Please see Figure 1.

Two factors are causing the bubble to shrink: (1) reduced drilling (the result of low energy prices and the gas "bubble"); and (2) increased gas demand (the result of lower gas prices and increased market share). By 1989, the "bubble" will have shrunk enough to spur drilling in the U.S. Thus, U.S. drilling will pick-up despite continued Canadian imports and, in fact, A.G.A. has even factored in a gradual increase in Canadian imports of one Tcf in 1988 and 1.4 Tcf by 1990. Yet, our analyses still show that excess supplies are gone after 1990, creating market-driven incentives for new drilling in the U.S.

Second, allegations have been made on both sides of the border that producers in the other nation have an advantage in competing for gas sales in U.S. markets. The focal point of these complaints by U.S. producers are programs such as the Canadian Exploration Development Incentive Program. In this program the Canadian government provides a federal cash grant of 33 percent of exploration and development expenditures up to a corporate limit of $10 million of eligible expenses/year. Because the benefit itself is taxable income, the typical benefit to a major drilling company is well below the $3 million level. As evidence of this, the Canadian government estimates that only about $300 million was granted in 1987. Some industry estimators believe that this overstates the amounts paid out. Even so, this program is scheduled to be reduced by half on October 1, 1988 and to disappear entirely by December 31, 1989.

Other factors which may favor one producer over another are taxes, both federal and local, and royalty holidays. Comparison of these programs in Canada and the U.S. is extremely difficult. A.G.A. has undertaken such a comparison, based on survey data, and with peer review. We plan to have the results available in mid-May.

Lastly, A.G.A. firmly believes that establishing a North American natural gas trade will rebuild customer confidence and allow gas to serve promising new markets for gas-fired cogeneration and combined cycle power plants. The price induced shortages of the late 1970s and the volatility of all energy prices since then, including gas prices, has eroded consumers' confidence in the U.S. gas resource base. The fear that natural gas was a "scarce" resource, embodied for example by the prohibitions on gas usage in the Fuel Use Act, continued even into the 1980s. It was not until last year that Congress finally repealed the Fuel Use Act and customers could buy gas for new industrial facilities and power plants without administrative impediments.

Although this legacy will be hard to overcome, one way to rebuild consumer confidence is to point to the enormous gas resource base of both the U.S. and Canada -- a combined 256 Tcf of proved reserves and 940 Tcf of potential and proved resources. Once the FTA is in place, with its assurances that Canadian supplies will not be withdrawn from the marketplace (except under the most extraordinary circumstances) and that prices will be market based, consumers will be able to make investment decisions based on total North American resources. While U.S. resources are large, the combination of U.S. and Canadian resources provides an extraordinary degree of supply security and with it price stability. These are the kind of assurances that investors in new gas-fired industrial and power plant projects need before making large capital commitments. Time and again, gas marketers have told us that it is difficult, if not impossible, to penetrate the market for new gas-fired cogeneration and combined cycle power plants unless the customer believes that gas resources are plentiful and that supplies will not suddenly be withdrawn from their markets for political reasons.

Increased consumer confidence can translate directly into an overall increase in demand for both U.S. and Canadian producers. In no way will U.S. producers lose out to Canadian producers under the Free Trade Agreement. Rather, both countries will benefit from increased confidence in supply security, and both countries' producers will share in increased demand for natural gas. Of this market, we expect the lion's share to go to U.S. producers, predicting that domestic production would serve 90% of a 21.7 Tcf market by the year 2010.[9] Thus, while the Free

Trade Agreement will have little effect on current gas trade, its real effect will be to build investor confidence and new gas markets in the future.

THE EFFECT OF U.S. NATURAL GAS REGULATIONS ON "FAIR" TRADE

There are also allegations that in order to have "fair" natural gas trade with Canada, a litany of discrete orders and opinions at the U.S. Federal Energy Regulatory Commission (which governs pipeline ratemaking) and the Economic Regulatory Administration (which authorizes energy imports and exports) have to be, variously, adopted into law in the case of FERC Opinion No. 256, eliminated in the case of FERC Order No. 500, or revised in the case of normal ratemaking procedures. We do not think that a treaty is the place to enact an entire regulatory agenda. Further, the alleged "unfairness" is either unrelated to the Free Trade Agreement and/or totally unsubstantiated.

For example, there are complaints that FERC Order No. 500 gives Canadian gas a marketing advantage over U.S. gas. Not so -- Order No. 500 requires all producers, both U.S. and Canadian, to offer take-or-pay credits when they avail themselves of open access transportation on a U.S. pipeline. Thus, producers in both countries are treated the same.

U.S. producers have opposed Order No. 500 crediting since its inception, and have in fact opposed any take-or-pay relief from FERC at all, but that has nothing to do with Canadian gas, fair trade, or the Free Trade Agreement. It has to do with proper U.S. rate and regulatory policies that stem from a lawful decision of our federal courts. Although U.S. producers may attack Order No. 500, it is important to keep in mind that:

> As a matter of U.S. law, this program is a direct result of a decision by the U.S. Court of Appeals, which required the Commission to address the take-or-pay contract issue, A.G.D. v. FERC, 824 F.2d 981 (D.C. Cir. 1987); and
>
> As a matter of policy, Order No. 500 actually helps make the pipeline neutral about whether to transport Canadian or U.S. gas. Before Order No. 500, pipelines incurred substantial take-or-pay liability by transporting domestic gas because most U.S. producers have not renegotiated their take-or-pay contracts. In contrast, they did not necessarily incur similar liabilities by transporting Canadian gas because Canadian producers have already renegotiated their take-or-pay contracts.

This imbalance was somewhat redressed by Order No. 500. Because transportation automatically earns take-or-pay credits under Order No. 500, any disincentive to transport U.S. gas compared to Canadian gas is gone. Thus, allegations that Order No. 500 discriminates unfairly against U.S. producers could not be more wrong.

As a second example, U.S. producers have also complained about FERC Opinion No. 256, even though it was a clear "win" for them. This specific case involves complicated ratemaking issues about how production and transportation costs for gas purchased in Canada and resold by a pipeline in the U.S. should be billed to the U.S. customers. FERC allocated more of those costs to the Canadian gas, making it relatively more expensive on the ground that it did not want to discriminate against U.S. producers. Now, having won this particular case, some U.S.

producers want to enact a particular rate design into law in conjunction the Free Trade Agreement.

They would also like legislation requiring ERA to put the same ratemaking conditions in FERC Opinion No. 256 in ERA's import authorizations. This would mean that a single federal case would affect rate designs for local distribution companies that buy Canadian gas directly. This is clearly going too far -- raising questions of federalism and the preemption of state regulatory authorities.

Finally, some producers want to use the FTA as an excuse to overturn other specific ERA and FERC decisions. These include an attempt to reverse ERA's decision that FERC regulates interstate transportation and that ERA should not try to put conditions on FERC Order No. 436. There are also complaints about ratemaking on the Northern Border Pipeline, a transporter of Canadian gas, even though many other pipelines (that transport only U.S. offshore gas) have similar financing arrangements and rate designs.

It seems clear that having failed to win before FERC, ERA, and/or the U.S. Courts, the complainants are using the Free Trade Agreement to achieve a failed regulatory agenda. The FTA is a treaty between two sovereign nations. It has outstanding national security, balance of energy-trade, and environmental benefits. Regulatory policy, however, raises separate and discrete issues that are inapplicable to such a trade agreement. Issues of state and federal ratemaking have traditionally been delegated to special regulatory bodies precisely because they are typically not amenable to legislation, and certainly not amenable to international treaty negotiations.

FOOTNOTES

1/ American Gas Association/Canadian Gas Association Joint Task Force, Long-Term U.S.-Canadian Natural Gas Trade, emphasis supplied, p. 4 (September 1987).

2/ Canada-United States Free Trade Agreement, Article 2003 (December 9, 1987).

3/ United States Department of Energy, Energy Security Report to the President, DOE/5-0057 (March 1987).

4/ National Defense Council Foundation, Will the Future Be Reflected in the Past? -- The DOE Energy Security Report One Year Later, Washington, D.C. (March 1988).

5/ American Gas Association, The Strategic Role of Natural Gas In Replacing Imported Oil, Arlington, Va. (May 22, 1987).

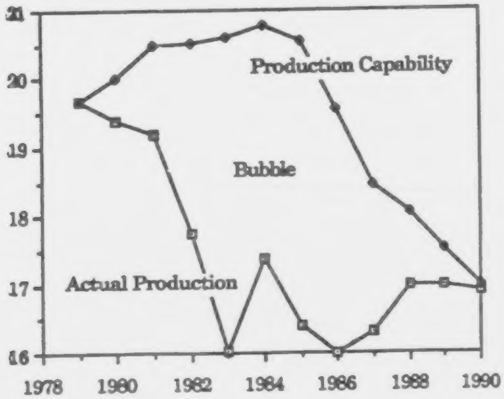
6/ A.G.A. Gas Supply Committee, The Gas Energy Supply Outlook Through 2010, Arlington, Va. (October 1985).

7/ Procter, R.M; Taylor, J.C. Wade, J.A.; Oil and Natural Gas Resources of Canada - 1983, Geological Survey of Canada, Paper 83-31; Department of Energy Mines, and Resources, 1984.

8/ American Gas Association, Natural Gas Production Capability - 1987-1990, Arlington, Va. (January 4, 1988).

9/ American Gas Association, TERA-Analysis 88-1, Arlington, Va. (January 15, 1988), at Table 3, p. iv.

Production and Production Capability: 1979-1990



Statement of Senator Donald W. Riegle, Jr.
Senate Finance Committee Hearing on the Canada FTA
April 12, 1988

Mr. Chairman, I want to thank you for convening these hearings on specific sectors of the U.S. economy which will be impacted both positively and negatively by the proposed Free Trade Agreement with Canada.

The zinc alloy industry is one sector which is seriously impacted by the FTA. According to Marvin Fink, an alloyer who recently testified before the Ways and Means Committee, it is threatened with extinction. Zinc alloying is not one of the giant industries of our nation but it is a vital industry. There are only 26 alloyers in 10 states. Yet, it should be noted that this industry is well represented on this committee -- Michigan has 4 alloyers, New York, 5, Pennsylvania 2, and Colorado and Kansas each have one. However, the total elimination of all tariffs on zinc alloy threatens to put most of these companies out of business within 4 years.

Although the industry is in the 10 year tariff phase-out, Canada will, by its own admission, begin to export zinc alloy into the U.S. to avail itself of the U.S. market and the protection it affords them from foreign producers of zinc alloy.

During the negotiations on the agreement, I made suggestions to mitigate the damage to this industry, once it became clear that an exemption from the tariff elimination was not being considered by our negotiatiors.

One suggestion was to freeze the total phase-out at 15 percent until the 10 year period had elapsed, to give zinc alloyers the time intended for import-sensitive sectors.

I will be seeking a clarification in the safeguard section of the agreement to define "substantial cause of serious injury" to insure that the zinc alloy industry will be able to avail itself of the three year freeze in tariffs for import-sensitive industries.

Our negotiators have said to this committee that there is nothing to preclude the U.S. from assisting industries who will be negatively impacted by this agreement. As I am sure we will hear from Mr. Sheinkman, Canada has implemented new protections in the past few months for its industries. Principally the textile duty-remission scheme. As this committee knows, Canada's practices in duty remissions are the subject of serious concern for me in the automotive sector which we will be hearing about later this week.

I joined several of my colleagues from the Finance Committee in signing a letter to Ambassador Yeutter regarding the textile duty-remission issue. It is a serious act by Canada, and one which exemplifies a lack of adherence to the standstill provisions of this agreement.

Statement of Carl F. Schwensen
National Association of Wheat Growers
before the
Senate Committee on Finance
on the
U.S.-Canada Free Trade Agreement
April 12, 1988

Mr. Chairman and Members of the Committee:

The National Association of Wheat Growers appreciates this opportunity to present its views on the pending U.S.-Canadian Free Trade Agreement. I am Carl Schwensen, executive vice president of the National Association of Wheat Growers which is headquartered in Washington, D.C.

Mr. Chairman, in March 1985 President Reagan and Canadian Prime Minister Mulroney began to develop a bilateral free trade agreement (FTA), and by December 1985 President Reagan had notified the Congress of his intention to enter into negotiations with Canada using "fast track" procedures. "Fast track" authority was granted by the Senate Finance Committee in April 1986, and a negotiated agreement was completed in October 1987. The final text of the U.S.-Canadian Free Trade Agreement has been agreed to by both governments, and the FTA is now subject to action by the U.S. Congress and the Canadian Parliament.

The NAWG recognizes the economic importance of bilateral trade and investment between the U.S. and Canada (over $200 billion was exchanged in 1986), and it supports the concept of "free trade." We must state, however, that we have some serious concerns about the wheat provisions of the U.S.-Canadian Free Trade Agreement.

While the U.S. and Canada enjoy more bilateral trade than any other two countries in the world, U.S. wheat farmers are also keenly aware that the two countries are fierce competitors in major wheat importing markets around the globe. Canada's marketing system is under the monopoly control of the Canadian Wheat Board, a Crown corporation with authority to buy, sell and transport grain. Exports are assisted by the "Crow's Nest Pass" system of subsidized rail rates, and the U.S. has been an eligible destination for these movements. These subsidies amount to about US$18 per ton or roughly 50¢ per bushel. Both the U.S. and Canada maintain duties on imported wheat, but Canada also operates a licensing system that grants licenses only if a product is not domestically available. At present, these licenses act as a virtual ban on wheat imports.

Historically, Canadian wheat exports to the U.S. have not been large, and most of the wheat entering the U.S. has gone to flour mills in the East. However, shipments have grown from 138,000 tons in 1984-85 to the current level of approximately 400,000 tons. This accelerated trend in exports to the U.S. has caused wheat growers to give close scrutiny to the terms of the Canadian Free Trade Agreement.

Under the FTA, Canada will gain essentially unrestricted access to the 30 million ton U.S. wheat market on January 1, 1989. While the U.S. has little to gain through exporting wheat to Canada, a market about one-tenth the size of ours, access will continue to be restricted by the licensing system until U.S. and Canadian support systems are "equalized." The level of U.S. and Canadian government support will be determined through the use of Producer Subsidy Equivalents (PSE's), a formula for computing relative subsidy levels which, in our view, is still methodologically flawed. The FTA does address the Crow's Nest rail subsidy, but the subsidies would be eliminated only as they affect shipments out of western ports, whereas wheat moves to the U.S. through eastern Canadian ports.

The U.S. retains the right to use "quantitive import restrictions" if imports significantly increase as a result of a "substantial change" in either country's support programs. For the U.S., this means that a new condition would be established to govern the use of Section 22 of the Agriculture Act of 1933. As the Committee is well aware, Section 22 is the mechanism for protecting our domestic price support programs from being undermined by foreign imports. After implementation of the FTA, a "substantial change" in U.S. or Canadian supports would be a prerequisite before Section 22 relief became available. This would be the case even in the event of an import surge driven by sharp currency differences or other economic incentives.

In the NAWG's view, provisions of the FTA relating to grain lack balance. The U.S. opens its border to wheat imports, while Canadian restrictions continue. Moreover, U.S. wheat markets and domestic farm programs become further exposed to the potential damage of Canadian exports.

Suffice it to say that the U.S.-Canadian FTA has shortcomings. To its credit, the Reagan Administration has been willing since the negotiations were completed to consult with wheat producers about their concerns. These consultations continue. In retrospect, we think that problems could have been avoided if there had been more opportunity for consultation and review before the agreement was finalized. This brings us to some observations on the entire "fast track" process.

Progress in a negotiation often comes during the last few weeks or hours of bargaining, and not all problems can be solved or even identified. Further, there is little opportunity for consultation during a marathon negotiation. Since agreements are not amendable under the "fast track" process which provides for a simple up or down vote, flaws cannot be corrected. This makes timely consultation and review vital to an acceptable outcome in the negotiations.

We can anticipate that with the Uruguay Round of world trade negotiations underway, more "fast track" agreements will be brought to the Congress for approval. If this process is to be successful, greater opportunity for oversight and review will be required.

In this regard, it seems to us especially important that the Congress assert its role - not only in pre-agreement consultations, but in the process of crafting acceptable implementing legislation. For that reason, we particularly appreciate this opportunity to testify and we commend the Committee's assertion of its integral role in developing the legislation.

Many wheat growers also produce barley and have an interest in the products that come from barley, such as barley malt. The U.S. barley malting industry could lose a great percentage of the North American market which it now serves because the FTA permits the continuance of the secretive pricing policies of the Canadian Wheat Board (CWB). What is needed is some transparency in the price setting policies of the CWB. The malting industry as asked that the committee include bill language to encourage transparency in exports; such provisions, including negotiations on acquisition prices and other matters, could help the wheat industry as well.

Thank you, Mr. Chairman. I will be pleased to respond to questions from the Committee at the appropriate time.

STATEMENT OF
JACK SHEINKMAN, PRESIDENT
AMALGAMATED CLOTHING AND TEXTILE WORKERS UNION, AFL-CIO

IN OPPOSITION TO
THE UNITED STATES-CANADA FREE TRADE AGREEMENT

INTRODUCTION

The U.S.-Canada Free Trade Agreement hurts workers on both sides of the border, despite the exaggerated optimism of our governmental leaders. While the idea sounds good in the abstract, the agreement negotiated by the Reagan Administration and being presented to Congress has so many problems and flaws that we must conclude that we are better off without it than with it.

Our union represents 282,000 members, including 30,000 Canadian members, who work mostly in the clothing and textile industries. We also have a significant number who work in other manufacturing industries affected by this agreement. No additional jobs will be created for our members. Some jobs will move North and some South in the various product areas of the textile and apparel industry, but in sum there will be no increase in the total; in fact, there will be a decrease.

The major consequence of this agreement will be to provide an incentive for imports from elsewhere to flood into both countries to take advantage of an enlarged market and of the inability of Customs to properly monitor the trade flows across our huge border. The existing quota agreements of both countries will be both more fully filled and more highly circumvented. We are also very concerned that the precedents set by this agreement will be extended to other countries or multilaterally through the current round of GATT negotiations.

Our nation has serious trade problems which is just stating the obvious. What bothers our union is whether this free trade agreement and its precedents will contribute toward reducing the continued hemorrhaging of our national wealth through the trade deficit and enhance our long term international competitiveness. The Administration has already spoken about negotiating free trade agreements with Mexico, the ASEAN countries, even Japan. Our union has contracts with numerous companies that have plants on both sides of the U.S.-Canada border and we have always worked closely with our Canadian members to insure that wages and working conditions are not askewed in favor of one side over the other. This is true even with many nonunionized companies -- a basic equality of labor market competitive conditions. But this certainly does not hold for other countries being considered for free trade agreements.

The Canadian Free Trade Agreement does not add to increased U.S. international competitiveness. The addition of a market of 20 million more people provides no additional economics of scale nor greater competition-created efficiencies. Most of that has already occurred through our existing trading relationship. But several new distortions have been added in this agreement that will prove harmful to American interests and add to our trade deficit.

You will be receiving testimony from the AFL-CIO detailing a number of inequities in this agreement. Our union concurs with their essential point that this agreement represents a loss of control and sovereignty over our basic trade laws governing subsidy, dumping, Section 301 unfair trade practices and Section 201 import relief. Our union is opposed to a system which makes final decisions affecting our member's livelihood removed completely from any necessity of accountability and from control of their own elected representatives. And if this sytem were to be extended further in other bilateral agreements or multilaterally through the Uruguay GATT trade round negotiations, we predict enormous difficulties and many undesirable consequences for U.S. workers.

For us in the textile and apparel industry, this precedent takes on enlarged proportions than for most others. The current Multifiber Arrangement (MFA) expires in 1991 and there is no assurance its regime will be continued, even in modified form. Thus we are vitually concerned about what future actions we could potentially take under Article 19 of GATT or any of our domestic trade laws to seek restrain from overwhelming or unfairly traded imports.

The U.S. textile and apparel industry is strongly affect by many other parts of this agreement.

I. Bigger Market Attracts More Imports

The U.S. already takes in a disproportinately high share of the developing world's exports of apparel products despite our quota agreements. The most current data show the U.S. receives 59 percent of developing country apparel exports, more than double the EEC and Japanese intake combined! (EEC receives 22.7 percent and Japan 5.6 percent of world exports.) Canada likewise takes in a disproportinate share of world exports. By creating a single market between the U.S. and Canada there is an even greater incentive created to concentrate world exports toward our market.

All major textile and apparel markets throughout the world are protected from imports to a greater or lesser degree, MFA, or no MFA. The U.S. is certainly less protected than most others. By combining the U.S. and Canada into a single market, and with the current Administration's policy to substantially expand apparel import quotas in the bilateral agreements it is negotiating, developing country exports will be even more heavily focused and concentrated on our market.

II. Transhipment and Fraud Will Increase

The textile and apparel rules of origin under this free trade agreement are so complex and unenforceable that unscrupulous importers will have very little problem undermining the quota restraint programs in either country. The U.S. Customs Service is already overwhelmed in efforts to enforce existing regulations. It admits to physically inspecting only 1% of all textile and apparel shipments that are entered. To now add a tariff-rate quota in both directions, while necessary for the industry, will make the job for Customs just that much more impossible. Importers will take advantage of quota agreement shortcomings in either country and tranship across the border. The penalties for fraud or mislabeling are so small relative to the potential monetary gain as to make them almost inconsequential.

III. No Implementation Provisions Are Set Forth

Neither in the free trade agreement nor in any legislation thus far introduced has any arrangement been made for interpreting or implementating the basic sections of the agreement. For example, Canada can send to the U.S. 50 million square yard equivalents of apparel made from fabrics produced in a third country at the reduced FTA duty rates. If these imports are concentrated or overloaded in one or a few market segments, entire sections of the U.S. apparel industry could be destroyed. Authority must be lodged somewhere to make and enforce regulations on how the agreement is to function, with the opportunity of having input into the setting of interpretation and regulation.

The new Canadian textile and apparel remission scheme discussed below raises the additional problem of how we police the third country duty free Canadian imports of shirts, blouses and outerwear apparel. We question how this program is congruent with apparel rules of origin in the agreement and how Customs will keep tabs on these items when re-exported to the U.S. Certainly an administrative nightmare has been instantly created.

IV: Duty Remission Scheme On Imported Fabrics and Some Apparel Into Canada

A new issue affecting the basic equality of undertakings in this agreement has suddenly arisen. The Canadian government has just announced a $63 million duty remission and duty reduction program on third country imported fabric used in apparel production subsequently exported to the U.S. (and elsewhere). This program gives a clear competitive advantage and direct export subsidy to Canadian apparel manufacturers that completely undermines the basic premise of a free trade agreement: competition to be on true free market conditions without governmental induced trade distorting practices undertaken by either side. Since a duty remission program is not available to American manufacturers the proverbial level playing field is strongly tilted in favor of the Canadians.

While the text of the agreement published last December allows such a subsidy program to be introduced by June of this year, we still feel we were blind-sided and is an indication of bad faith by the Canadian government. It makes us wonder how many other ways the agreement equity can be undermined by cleverness and loopholes.

From our perspective, this U.S.-Canada free trade agreement is symbolic of the general policy of sacrificing manufacturing industries - especially labor intensive ones - for presumed gains in services and investment. We strongly question whether the value-added in the new jobs created even approximates that of the jobs that are being lost. We ask where will the million American and thousands of Canadian apparel workers find alternative employment, given their demographic, social and educational handicaps?

We think the Administration and the Congress ought to be spending its efforts in the trade area seeking to reduce the enormous trade deficit rather than negotiating agreements that may add even more to that deficit.

PREPARED STATEMENT OF MAX TURNIPSEED

OFFICE OF THE CHEMICAL INDUSTRY TRADE ADVISOR

The Office of the Chemical Industry Trade Advisor (OCITA) is pleased to have this opportunity to express its views on the United States - Canada Free Trade Agreement (FTA). The FTA is an important step toward free trade with the largest trading partner of the United States. OCITA supports the Agreement, and urges that appropriate implementing legislation be passed by the 100th Congress. We commend the U.S. negotiators on this historical achievement, and look forward to providing advice and working with the Congress in the FTA implementation process.

OCITA was established in 1973 to coordinate the chemical industry's responses to and policy determinations on trade matters under consideration by the U.S. government.

OCITA represents the Chemical Manufacturers Association (CMA), the National Agricultural Chemicals Association (NACA), the Synthetic Organic Chemical Manufacturers Association (SOCMA), and the Society of the Plastics Industry, Inc. (SPI). OCITA's members represent an important part of this Nations' productive capacity for industrial chemicals. In 1986, shipments of chemicals and allied products amounted to $216.2 billion, of which 10 percent were exports. In 1987, the chemical industry accounted for more than $9.5 billion in trade surplus. Trade with Canada accounts for a significant portion of the industry export shipments. The FTA not only affects our exports to Canada but the overall economic health of the industry as well.

Introduction

Throughout the negotiations on the FTA, OCITA monitored the potential effects of the Agreement on the chemical industry and offered advice to the Administration. The FTA signed on January 2, 1988, by President Reagan and Prime Minister Mulroney reflects much of that advice and addresses many of the concerns OCITA raised during the process. The Agreement should advance the economic interests of the United States, and OCITA believes it will benefit the chemical industry. This is not to say that we are completely satisfied with the FTA. We believe that certain provisions can be improved and urge that future work be so directed as the FTA is implemented. Our comments on the areas where we would like to see improvements made are not intended to convey qualified support for the FTA. They are intended as statements of direction for future improvements of the FTA.

The remainder of OCITA's statement expresses our views regarding specific provisions of the FTA, their impact on the chemical industry, and our recommendations for Congressional consideration during the debate on FTA implementing legislation. OCITA recognizes that use of the so-called "fast-track" approval procedures (Section 151(c) of the Trade Act of 1974, 19 U.S.C. < 2191(c)) will preclude amendments to the implementing legislation, but offers its views in the hope that our suggestions will be considered by the Congress and the Administration as they finish drafting the appropriate legislation.

A. Energy

OCITA welcomes the energy provisions (Articles 901-909) of the FTA that provide for unrestricted and secure energy market access, elimination of two-tier pricing and the prohibition of import/export taxes and fees. Additionally, the provisions related to energy regulatory measures, national security restrictions, and state/provincial governments should enhance access to hydrocarbon supplies and enforcement mechanisms, and improve opportunities for supplemental consultation on energy sector disputes that may develop. Overall, OCITA believes the energy provisions of the FTA will benefit the chemical industry.

B. Tariff Reductions

The tariff eliminations covering chemicals (Article 401) reflects the advice of the industry. In OCITA's view, these provisions are completely acceptable assuming the non-tariff barrier obligations under the FTA are met. The tariff staging provisions for chemicals provide for balanced reductions of U.S. and Canadian tariffs on chemical products to allow for adjustments that will be necessary.

We are particularly pleased with Article 401.5, which provides for consultations leading to the acceleration of a scheduled tariff elimination. Although it does not of itself establish a procedure by which acceleration agreements will be reached, OCITA urges that implementing legislation stipulate that the private sector must be involved in consultations for accelerated tariff elimination. We believe that neither the U.S. nor Canadian governments should unilaterally initiate the accelerator provisions of the FTA without some initiative from the private sector. OCITA believes it is essential that the potentially-affected industry be consulted prior to negotiations by the U.S. government. Moreover, controversial or disputed accelerations should not, as a matter of policy, be the subject of negotiations in this area.

C. Rules of Origin

OCITA believes that the rules of origin (Articles 301-304) applicable to chemical products will substantially reduce the opportunities for third-country imports to receive preferential treatment in the context of U.S.-Canada trade. In addition to a requirement for combined U.S.-Canada raw material and manufacturing costs of at least 50 percent, the FTA also provides specific rules for certain chemical products in Annex 301.2, Sections VI and VII. These sector-specific rules establish an excellent working foundation for the negotiation of similar, multilateral rules of origin in the Uruguay Round on the General Agreement of Tariffs and Trade.

D. Investment Provisions

OCITA is generally pleased with the investment provisions of the FTA (Articles 1601-1611). In particular, OCITA welcomes the elimination of performance requirements and the prohibition on the adoption of more stringent investment-related requirements than those in effect on October 4, 1987. On balance, the investment provisions of the FTA should reduce barriers to investments, encourage increased capital flows and help create of new jobs in both the United States and Canada.

OCITA is concerned, however, with the review provisions of the FTA. The Agreement establishes a higher threshold review level for investments in Canada of C$150 million -- a level certain to include most of the chemical-related acquisitions which may be undertaken in the future. It does not eliminate all review procedures and restrictions, nor does it change the existing restrictions on oil operations with respect to future investments. Additionally, OCITA believes that further clarification of the "grandfather" provisions for inconsistent, existing legislation, as well as more complete definitions of direct and indirect investments, are required. For example, it is unclear at what point a firm will be considered to be foreign-controlled for the purpose of investment reviews.

E. Safeguards

Aside from consultations permitted under Article 1804, the FTA provides no remedy for temporary trade distortions caused by currency fluctuations. In OCITA's view, exchange rate fluctuations strongly influence trade flows, and remedies in addition to consultation are warranted. Consultation on exchange rates may not be enough in the short term. Remedies such as a special surcharge or other temporary adjusting remedies should be considered.

In addition, OCITA is concerned that the modification of the existing U.S. safeguard statute (Section 201 of the Trade Act of 1974) may seriously restrict the ability of U.S. industries injured by the duty-free entry of Canadian goods to obtain the full relief currently provided in Section 201. FTA Articles 1101 and 1102 would apply more stringent standards for import restrictions on Canadian goods than is currently permitted. OCITA recognizes that changes may not be possible in this area, but hopes that industries suffering injury will be able to obtain appropriate redress through the dispute resolution procedures of the Agreement.

F. Dispute Resolution

OCITA believes that the general provisions regarding dispute resolution (Article 1801-1808) are fair and workable, but the question of private sector involvement in the dispute resolution procedures must still be resolved. Under Article 1807, if the United States - Canada Trade Commission does not resolve a dispute within 30 days, and does not refer the matter to binding arbitration, and if either party so requests, the Commission must establish a panel of experts to hear the matter. Similarly, Article 1904 provides for binational review of decisions relating to antidumping and countervailing duty matters. While the procedures particular to each of the two types of panels differs, the FTA does not detail the qualifications of panelists (except that no binational panel member may be "affiliated" with either party, under Article 1901.2).

OCITA urges that the implementing legislation expressly provide that non-governmental experts -- preferably drawn from the affected industries -- be eligible for selection to the panels. In every case, selection should be based on the technical expertise of the proposed panel member on the issue raised in the dispute. Further, the implementing legislation should designate the federal office responsible for naming and approving persons to the roster of eligible panelists. With these changes, those best qualified to bring the necessary technical expertise to the process can become an essential element in the decision-making process.

A notable disappointment is the loss of the right under U.S. antidumping and countervailing duty cases to judicial review prior to either contracting party being able to invoke the binational panel provisions. The requirement that future U.S. trade legislation must address its applicability to Canada under the FTA provisions is also a disappointment. In OCITA's view, these provisions should not be considered a model for other trade agreements.

G. Protection of Intellectual Property

Article 2004 of the FTA provides that the United States and Canada "shall cooperate in the Uruguay Round of multilateral trade negotiations and in other international forums to improve protection of intellectual property." Thus, despite implicit recognition that intellectual property concerns merited consideration by the negotiators, the FTA imposes no substantive obligation on either party. In fact, neither the United States nor Canada is committed to undertaking any bilateral negotiations aimed at an agreement, or even developing a framework to address intellectual property matters.

OCITA is concerned that intellectual property issues considered in a multilateral framework such as the Uruguay Round may not receive the priority attention they deserve. For this reason, OCITA supports the addition of language in the U.S. implementing legislation which provides for a commitment to negotiate substantive provisions for intellectual property protections with Canada, after the FTA is implemented. Such language would not detract from the FTA, but would encourage the conclusion of an intellectual property agreement which could serve as a useful model for the Uruguay Round.

In the FTA, the United States and Canada reached no agreement relating to the preservation of existing intellectual property protections, or relating to the imposition of more stringent licensing requirements or similar restrictions. OCITA believes that a commitment on the part of the United States to maintain the status quo (as in the energy and investment provisions) for intellectual property protection would provide an incentive for the conclusion of a bilateral agreement in the near future.

H. Subsidies

With the exception of Article 1907, which establishes a Working Party to consider "rules and disciplines concerning the use of government subsidies," the FTA contains no substantive provisions regarding subsidies. The absence of any substantive, subsidy-related provisions not only fails to provide the Working Party with adequate direction, but also fails to state that countervailable government subsidies are undesirable instruments of trade policy. Article 104, by expressly continuing the obligations of each country under consistent instruments, effects no change in the application of the GATT Articles VI and XVI, and the GATT Subsidies Code. Additionally, Article 2011 allows for the commencement of dispute resolution procedures if, for example, a subsidized import "nullifies or impairs" an expected FTA benefit. However, these provisions are inadequate to encourage a full review of government subsidy programs, and will not promote measures necessary to reform such subsidy systems. OCITA believes that the FTA implementing legislation should provide some basic direction to the Working Party on subsidies, at least in focusing efforts on defining "actionable" subsidies. Transparency in the Working Party deliberations should also be encouraged to allow for the consideration of private sector views during the process.

Conclusion

The Office of the Chemical Industry Trade Advisor appreciates this opportunity to present its views on the U.S. - Canada Free Trade Agreement supports the FTA and OCITA. Efforts should not stop to build on the FTA and to add to its new provisions. The FTA establishes a basis to facilitate such future negotiations in areas where needed development has already been acknowledged.

OCITA believes the FTA will facilitate future trade negotiations in a number of unresolved areas. The suggestions and additional procedures we have outlined in this statement are intended to strengthen the U.S. position in this and similar agreements. We offer to provide Congress and the Administration with any assistance that may be necessary in implementing this new trade relationship with Canada.

OFFICE OF THE CHEMICAL INDUSTRY TRADE ADVISOR

2501 M STREET, N.W., WASHINGTON, D.C. 20037 • (202) 887-1149

June 7, 1988

The Honorable Lloyd Bentsen
Chairman
Committee on Finance
United States Senate
Washington, D.C. 20510

Dear Mr. Chairman:

We are writing in response to several questions posed by members of the Committee on testimony delivered April 12, 1988 by Mr. Max Turnipseed on behalf of the Office of the Chemical Industry Trade Advisor (OCITA). Mr. Turnipseed conveyed OCITA's support for the U.S./Canada Free Trade Agreement (FTA) and outlined specific areas where further progress is desirable after implementation of what has been negotiated.

The questions in particular that you requested additional information on concerned the extent of chemical industry support for OCITA's position, and our views on intellectual property protection (Draft Transcript, 4/12/88 hearing, at p. 26). To OCITA's knowledge, its position on the FTA represents that of the vast majority of chemical companies represented by four trade associations: the Chemical Manufacturers Association, the Synthetic Organic Chemical Manufacturers Association, the National Agricultural Chemicals Association, and the Society of the Plastics Industry. OCITA is not aware of any chemical company which has voiced a different position on IPR in the FTA.

In response to the questions raised by you and Senator Roth (draft transcript at p. 47-48) regarding intellectual property, we have the following additional comments. OCITA's recommended approach -- that the U.S. and Canadian governments commit to negotiation toward conclusion of a bilateral intellectual property rights agreement -- is premised on the belief that the multilateral trade negotiation is not the only appropriate forum to discuss intellectual property rights. Frankly, OCITA is concerned that reliance on the Uruguay Round to produce an agreement on intellectual property is well intended, but may dilute the relative importance of intellectual property to United States' interests. OCITA therefore recommends that the U.S. and Canadian governments negotiate a bilateral agreement which can then serve as a useful model for the Uruguay Round.

Senator Roth also requested information on the compatibility of U.S. and Canadian copyright laws. OCITA's members generally do not face problems in complying with the U.S. and Canadian copyright laws. However, OCITA is aware that some companies (not in the chemicals sector) have experienced difficulty in meeting the often differing requirements of the two copyright systems, and believe that some effort should be made to harmonize the programs.

With respect to concerns, questions and comments regarding the Working Group on subsidies, OCITA strongly recommends that private sector experts be consulted during the negotiations on increased subsidies discipline. OCITA notes with approval that the Finance Committee's recommendations on the FTA implementing legislation included a consultation provision. We urge the Congress to encourage a specific agenda and objectives for the Working Group within these provisions. We look forward to assisting Congress and the Administration in the effective implementation of a private sector consultation process.

Senator Mitchell requested information on the extent OCITA was consulted by U.S. negotiators on the FTA (draft transcript at p. 39). OCITA has over the years established a close working relationship with the Office of the U.S. Trade Representative and the U.S. Department of Commerce, and as a result OCITA was involved in consultations with the U.S. negotiators on the FTA. Most of these consultations were through several members of OCITA member companies that are represented on the Industry Sector Advisory Committee for Chemicals and Allied Products (ISAC-3).

On the question concerning the fast-track process, OCITA supports the fast-track approval process if consultation with the private sector is considered standard procedure. We look forward to close consultation with both Congress and the Administration as other "fast-track" approvals are undertaken.

OCITA would like to take this opportunity to note its support for the Committee recommendation on implementing Article 401 of the FTA, regarding tariff eliminations. The Committees have recommended that any duty modifications pursuant to the tariff elimination acceleration provisions be subject to the consultation/layover requirements. In effect, the President must first seek advice from the private sector and the International Trade Commission before implementing any change in the FTA by Presidential proclamation. This approach is wholly consistent with OCITA's suggestions to the Committee, with the exception that we had hoped that implementing language or report language would clarify that controversial items not be considered for accelerated reduction.

If we may provide any additional information on OCITA's position, please feel free to contact Mr. K. James O'Connor, Manager, International Trade, Chemical Manufacturers Association, at 887-1130.

Very truly yours,

Allen J. Lenz
Deputy Chemical Industry
Trade Advisor

COMMUNICATIONS

WRITTEN STATEMENT OF WILLIAM T. ROBISON

PRESIDENT, AMERICAN PLYWOOD ASSOCIATION

Before The

SENATE FINANCE COMMITTEE

Concerning

THE FREE TRADE AGREEMENT AND THE U.S. PLYWOOD INDUSTRY

April, 1988

Background

Currently, high tariffs inhibit plywood trade between the United States and Canada. Even if the plywood tariffs were removed, however, while Canadian plywood could compete openly in the United States, nontariff barriers would prevent most U.S. plywood from competing in the largest segment of the Canadian plywood market, the Canadian construction market. The Canadian construction plywood market alone, the market that most U.S. plywood is barred from, is worth approximately $490 million annually.

The Canadian barriers take the form of standards that bar the use of D-grade veneers or Southern Yellow Pine in construction plywood. Plywood made with D-grade veneers and Southern Pine constitutes about 80% of total U.S. plywood production. There is no economical way that U.S. producers of this plywood could modify their operations to produce plywood to meet the Canadian standards. Moreover, they should not have to.

Most countries, including the United States, accept plywood produced to other countries' standards. For example, U.S. C-D plywood is accepted by countries throughout the world, except Canada. Further, the United States accepts plywood from other countries if it meets the building code performance standards.

Canada, however, will not accept panel products for its construction markets unless they meet the Canadian standards. Currently, these standards are not solely performance standards, e.g. based on the strength or durability required for a particular use. Rather, they are based on arbitrary grade specifications which exclude D-grade veneer and require wood species indigenous to Canada.

Based upon performance for its intended use, U.S. plywood is every bit as good as Canadian plywood. There is no performance justification for the exclusion of panels with southern pine or D-grade veneer.

For years the United States and Canada have sought to resolve the problems created by Canada's nontariff plywood barriers. For example, in the Tokyo Round of Multilateral Trade Negotiations, it was agreed that the plywood tariffs would be reduced only after the nontariff barriers had been eliminated. This never occurred, however, because at that time the two industries were unable to harmonize their standards.

The Free Trade Agreement

Recognizing that it would be manifestly unfair to permit Canadian plywood access to the U.S. market while at the same time allowing discriminatory Canadian standards to exclude U.S. plywood from the Canadian construction market, the United States insisted in the FTA negotiations that Canada take some steps to begin the process of removing discriminatory barriers. In a side letter to the Agreement, Canada agreed that by March 15, 1988, the Canadian Mortgage and Housing Corporation would evaluate C-D plywood for use in housing that it finances, accounting for about 10% of the Canadian construction plywood market. If the evaluation resulted in CMHC permitting the use of C-D plywood in housing that it finances, tariff cuts on structural panels would have begun as soon as the FTA took effect. If CMHC disapproved the use of C-D plywood, and the disapproval was not affirmed by an impartial expert panel, the FTA allowed the United States to postpone structural panel tariff cuts until the matter is resolved.

Canada's Breach of the Plywood Provision

In fact, the CMHC did not do the evaluation of C-D plywood called for in the side letter. CMHC merely observed that U.S. plywood failed to meet the discriminatory Canadian standards, a fact that has been well known for years, and that Canada may change those standards some time in the future, surely not grounds to remove our tariffs at this time. Since there was no technical evaluation of U.S. plywood, there is nothing for a technical panel to review.

Canada's action breached the plywood provisions of the FTA. U.S. Trade Representative Yeutter agrees. He has stated that CMHC's action was "definitely violative of the Free Trade Agreement." Without an evaluation by the CMHC, U.S. plywood will be totally frozen out of the Canadian construction plywood market. As a result, the American Plywood Association requested the Administration to invoke its rights under Article 2008 of the FTA and refuse to lower tariffs on structural panels until the plywood problem has been satisfactorily resolved.

Canada has breached the FTA side letter, and continues to maintain the unfair nontariff barriers. The U.S. plywood industry would be seriously injured if we open our plywood markets while the Canadian markets remain closed.

U.S. Response to the Canadian Breach

The Administration has taken the position in negotiations with Canada that there will be no tariff cuts until the standards problem has been satisfactorily resolved. The American

Plywood Association fully supports this position. Canada, however, continues to demand that the Administration convene a technical panel to review the CMHC decision even though there is no technical evaluation to review. This should not be permitted.

The Administration currently supports a proposal made by Senator Packwood to have technical experts from the forest products laboratories of the two nations meet to harmonize the U.S. and Canadian standards for structural panels. Since CMHC indicated that Canada is considering adoption of performance standards, there is a basis to support such negotiations. Under this plan, however, no tariff reductions are to occur until Canadian and U.S. plywood standards are harmonized by the two countries' technical experts and the new standards are incorporated into the building codes of the two countries.

While the APA fully supports the U.S. government's efforts to solve the standards problem, these efforts are currently only a negotiating position. The position could change at any time, depending on Canadian reaction or on other matters of dispute between our two countries. The postponement of phased tariff reductions on structural panels until the plywood standards issue is resolved, pursuant to our rights under Article 2008 of the FTA, must be made mandatory.

This can be done either by an explicit commitment by the Administration, or in the FTA's implementing legislation. That legislation should:

-- give the President the authority to negotiate the plywood problem with Canada,

-- indicate that tariff reductions on structural panels will not occur until

a) Canada and the United States have adopted common, performance standards for structural panels, and

b) those standards have been incorporated into building codes in the two nations, and

-- in any case, provide that the reduction in tariffs should be a phased reduction occurring over a minimum of 7 years.

Conclusion

The U.S. plywood industry is one of the most competitive industries in the world. It is willing to compete with any industry on fair terms. It would be grossly unfair, however, for the United States to open its markets to Canadian plywood while unfair nontariff barriers keep U.S. plywood out of the Canadian construction plywood market.

Pursuant to Article 2008 of the Free Trade Agreement, the United States should not lower the tariffs on structural panels until Canada and the United States adopt common, performance standards for structural panels and those standards are incorporated into the building codes of the two nations.

SEALEGS

Ms. Laura Wilcox
Hearing Administrator
205 Dirksen Senate Building
Washington D.C. 20510

FOR INCLUSION IN THE OFFICIAL RECORD OF THE SENATE FINANCE COMMITTEE HEARING ON THE IMPLEMENTATION OF THE U.S.-CANADA FREE TRADE AGREEMENT.

It is with great anticipation that we welcome the Senate hearings regarding the free trade agreement between the United States and Canada.

The Berelson Company has, in one way or another, been involved in the import/export business for over fifty years. During this time we have experienced a consistent growth in our economic relations with Canada. Our common culture and peaceful border have created an economic climate in which both countries have prospered.

We entrust the honorable Members of Congress with our support in the belief that they will help to negotiate a treaty that is fair, comprehensible, and beneficial to all. We ask that any Member who is inclined to subject this treaty to unnecessary risk in order to promote himself or his party to refrain from doing so. The importance of this treaty outweighs the legitimacy of special interests. With regards to duties, we hope that Congress will adopt a policy that will eliminate these barriers as quickly as possible. The sooner true free trade is instigated between our two countries, the sooner our economic and social relations will be enhanced.

It is our belief that this treaty, along with the implementation of the Harmonized System, will help the United States to better compete in the ever changing global economy. We ask that Congress use whatever labor and wisdom necessary to acheive this goal.

Sincerely,

Richard B. Avery

Richard B. Avery
Vice President - Operations
The Berelson Company

The Berelson Company
100 Pine Street
San Francisco, California 94111
Telephone 415 956-6600
Telex 4949518 TBCSF
Telecopier 415 956-7438

STATEMENT OF

GALE P. FOSTER, EXECUTIVE DIRECTOR
CORDAGE INSTITUTE

TO THE

FINANCE COMMITTEE
UNITED STATES SENATE

IN OPPOSITION TO

THE U.S.-CANADA FREE TRADE AREA AGREEMENT

APRIL 8, 1988

The Cordage Institute is a trade association of domestic manufacturers of cordage products made from natural and man-made fibers. The Institute is located at 42 North Street, Hingham, Massachusetts.

The Cordage Institute is opposed to the U.S.-Canada Free-Trade Area Agreement. We oppose the Agreement on several grounds: the recently proposed Canadian duty remission scheme on imported fabrics; the problem that we forsee with transshipment; the dilution of U.S. trade laws; and last, but not least, the precedent that this Agreement establishes for similar types of trade arrangements outside the multilateral framework.

I. DUTY REMISSION SCHEME

The duty remission scheme on imported fabric is in effect a subsidy to Canadian apparel producers yet this subsidy was not even put into effect until the Agreement between the U.S. and Canada was signed. Under the circumstances, we suggest that Congress should have some concerns about the credibility of undertakings in the Agreement. While not technically a violation of the Agreement, this scheme is inconsistent with the standstill provisions of the Agreement.

II. TRANSSHIPMENTS AND OTHER CUSTOMS ABUSES

However well-intentioned the rules of origin may be in the Agreement, we believe that the U.S. Customs service is already on overload; hard pressed to enforce existing regulations, the new requirements and burdens associated with the Agreement will further exacerbate an already untenable situtation at Customs. The Agreement will encourage transshipment because the elimination of duties will make it worthwhile, and in the process quota circumvention will be rife.

III. THE DILUTION OF U.S. TRADE LAWS

We believe there are major gaps in the Agreement that will leave certain U.S. industries defenseless against injurious Canadian imports.

The U.S.-Canada Agreement contains no requirement that Canadian subsidies be eliminated. Canadian federal and provincial subsidies are pervasive in the Canadian economy.

The dispute settlement mechanism in the Agreement further weakens the ability to offset unfair trade practices. The elimination of judicial review in cases dealing with unfair trade practices and the substitution of binational panels substantially weakens the ability to act against subsidy and dumping practices.

The Agreement also places limits on Section 201 "escape clause" relief in cases where Canadian goods are involved.

IV. PRECEDENTS SET BY THE CANADIAN AGREEMENT

Our members have concerns that the Agreement will establish a precedent to initiate similar negotiations with other countries. Treasury Secretary Baker has written about a "market liberalization club approach, through minilateral arrangements or a series of bilateral agreements" based on the U.S.-Canada Agreement. Others have suggested free-trade agreements with Japan, Korea, Mexico and the ASEAN countries. According to the Reagan Administration, a number of nations have expressed interest in such agreements.

Already we have such an agreement with Israel. Some in Congress have proposed legislation to extend these free-trade area benefits to textiles and apparel for the Caribbean countries. The cumulative impact of these arrangements will be devastating for the U.S. textile products industries, like cordage, already under seige by imports.

This is not a free-standing arrangement. What is negotiated here will be sought by our other trading partners. In fact, the Israelis are demanding that the dispute settlement mechanism be added to the U.S.-Israel FTA. These individually negotiated agreements, which seem more attuned to foreign policy objectives than economic ones, are not a sound way to create or conduct U.S. trade policy, and we hope Congress will have the wisdom to stop what is happening in this area before more damage is done.

McHENRY & STAFFIER, P.C.
ATTORNEYS AT LAW
SUITE 408
1300 NINETEENTH STREET, N.W.
WASHINGTON, D.C. 20036

GEORGE W. McHENRY, JR.
JOHN R. STAFFIER
JOHN H. BURNES, JR.
SHIPPEN HOWE

TELEPHONE
(202) 467-5880

April 19, 1988

Hand Delivered

The Honorable Lloyd Bentsen
Chairman
Committee on Finance
SD-205 Dirksen Senate Office Building
Washington, D.C.

RE: Hearings before the Senate Committee on Finance in connection with the United States-Canada Free Trade Agreement (April 13, 1988)

Dear Senator Bentsen:

In testimony presented to the Committee on April 13, 1988, the Independent Petroleum Association of America ("IPAA") criticized the regulatory treatment which has been accorded to the Alaska Natural Gas Transportation System ("ANGTS"), including the prebuilt portions thereof. Specifically, an IPAA spokesman, Mr. Danny Conklin, stated that "the prospects are slim that the ANGTS ever will be built," and that the unique regulatory status of the ANGTS is being exploited in order to assist the marketing of Canadian gas through the prebuilt portions of the system.

On behalf of Foothills Pipe Lines (Yukon) Ltd. ("Foothills"), the Canadian sponsor of the ANGTS, I am writing to set the record straight on the status of the ANGTS. In particular, I would like to make three points.

First, the ANGTS is genuinely a special project which is entitled by law to certain forms of unique regulatory treatment. Among other things, it is based upon a special act of Congress -- i.e., the Alaska Natural Gas Transportation Act of 1976 -- and several regulatory, presidential, and congressional decisions issued under that act. It is also based upon an important bilateral agreement, namely, the "Agreement between the United States of America and Canada on Principles Applicable to a Northern Natural Gas Pipeline."

Second, in those situations in which the Federal Energy Regulatory Commission has refused to apply a generic rule to the prebuilt portions of the ANGTS, it has done so in order to preserve the minimum revenue stream which was essential to the financing of the prebuild phase. In its 1980 orders approving the prebuild phase, the Commission repeatedly assured the ANCTS sponsors that it would not take any future action which would undermine the integrity of this minimum revenue stream. Moreover, both the Commission and the U.S. courts have recognized that any interference with the minimum revenue stream would constitute a breach of various commitments made by the United States to Canada in order to secure Canadian participation in the ANGTS prebuild project. *See, e.g., Wisconsin Gas Company v. F.E.R.C.*, 770 F.2d 1144 (D.C. Cir. 1985), *cert. denied*, 1065 S. Ct. 1968 (1986).

Finally, Foothills strongly disagrees with the suggestion that the remaining portions of the ANGTS will not be completed. We remain convinced that Alaskan North Slope gas will be needed by the lower forty-eight states, and that the ANGTS will be completed by the mid-to-late 1990's. Furthermore, as a result of favorable developments in interest rates, inflation, and technology, the cost of the project will be substantially less than originally estimated.

By focusing on the ANGTS, I do not mean to suggest that Foothills agrees with the remainder of IPAA's testimony. To the contrary, Foothills believes that the allegations concerning "unfair" preferences for Canadian exporters are untenable. Moreover, we strongly support the Free Trade Agreement and the spirit of open, bilateral trade which is embodied therein.

Foothills appreciates this opportunity to present its views on these matters to the Committee, and respectfully requests that this correspondence be included in the Committee's hearing record. If you have any further questions concerning our position, please do not hesitate to notify me.

Very truly yours,

George W McHenry Jr

George W. McHenry, Jr.

Counsel for
FOOTHILLS PIPE LINES
(YUKON) LTD.

CWM:jsj

STATEMENT REQUIRED BY FOREIGN AGENTS REGISTRATION ACT

In accordance with the requirements of Section 4 of the Foreign Agents Registration Act of 1938, McHenry & Staffier, P.C., 1300 Nineteenth Street, N.W., Washington, D.C., 20036, and Wexler, Reynolds, Harrison & Schule, Inc., 1317 F Street, N.W., Washington, D.C., 20004, hereby state that they are registered under the Act as agents for Foothills Pipe Lines (Yukon) Ltd., a Canadian company.

Statement of

Dr. Peter T. Nelsen

Chairman and CEO

International Trade Council

Testimony on U.S.-Canada Free Trade Agreement

Mr. Chairman and Members of the Senate Committee on Finance. I am Dr. Peter Nelsen, President of the International Trade Council. We thank you for the opportunity to provide written testimony on the U.S.-Canada free trade negotiations.

The International Trade Council (ITC) is a trade association representing large and small businesses from the entire spectrum of exporting industries. Dedicated to defending and expanding free trade, overseas development and private sector investment, ITC is the original sponsor of the U.S. International Trade Center (USIT) and the International Development Institute. USIT is a permanent, year-round trade center designed to assist small, medium and large companies in entering the export market. USIT will provide 5,000 exhibitors with access to 400,000 foreign buyers annually; joint shipping, financing, insurance, and marketing arrangements. In addition, IDI also provides education, training, and technical assistance to exporters.

The Under States and Canada are great friends and neighbors. We share the world's longest undefended border and the largest trading relationship. Millions of Americans and Canadians freely cross the border to shop and visit each year. Our defense ties with Canada are more extensive and intimate than with any other Country. We work together through NATO, the North American Aerospace Defense Command (NORAD), and the Permanent Joint Board on Defense.

Nonetheless, despite our very close friendship a trade war with Canada is a distinct possibility if the current free trade negotiations fail. We are already in a trade skirmish.

In March 1985, Canada reinstated a trade provision that enabled foreign manufacturers to receive remissions of Canadian duties on imports from their home countries based on their exports to the United States. The United States has protested that this constitutes an export subsidy. In early 1986, under pressure from American timber companies, the U.S. imposed a 35 percent tariff on Canadian cedar shakes and shingles. Canada retaliated by increasing its tariffs on computer parts, books and a variety of other products. In October 1986, the U.S. Commerce Department determined that Canadian province softwood timber pricing constituted an export subsidy. To avoid a threatened countervailing duty, Canada imposed a 15 percent export tax on softwood lumber in December of 1986.

Canada in turn has begun flexing its own protectionist muscles. In March 1987, the Canadian government imposed a 67 percent countervailing duty on U.S. corn imports to counter American agricultural subsidies. That same month, Canada proposed to bar foreign firms from distributing films in Canada for which they held the U.S. distribution but not the worldwide rights. This proposal would reduce U.S. movie sales in Canada by about 20 percent.

America's protectionist impulse has been fueled by a myth. This myth claims that foreign imports are stealing American jobs particularly in manufacturing. That just is not true. The American economy created 8.4 million new jobs from 1978 to 1985 -- far more than Japan and Western Europe combined. In addition, U.S. manufacturing employment has held steady around 19 million since 1970, while total employment of production workers rose from 47 million in 1975 to 62 million in July 1985.

The cost of a trade war will be higher prices for American consumers and lost jobs for U.S. workers. The cedar shake and shingle tariff cost new home buyers an extra $800 according to the National Association of Home Buildings. The softwood lumber tax has been estimated to price 120,000 families out of the housing market in the next seven years and cost those who can still afford a new home $227 million annually. American jobs are lost when Canada seeks to protect its industries with stiff tariffs and limits American companies' access to its markets.

A free trade agreement could break this cycle of "tit for tat" protectionism and defuse the looming trade war. A free trade agreement would also yield several additional benefits. Canadian tariffs are must higher than ours on the average. Thus, phasing them out would benefit American exporters according to the Office of the United States Trade Representative, if Canada cut its tariff rates to the level of other industrialized countries, American exporters could increase their annual sales by $500 million annually. In return, Canada would be given secure access to the U.S. market. Elimination of tariffs would also modestly lower the cost of living for consumers. In return, Canada would receive secure access to the American market.

It has been estimated that a free trade agreement with Canada would raise the U.S. gross national product by $12-17 billion and create 500,000 to 750,000 jobs. Because Canada's economy is much more dependent on exports, it would receive proportionately an even greater increase in its gross national product.

A U.S.-Canada free trade agreement could also substantially promote the further negotiation and establishment of a North American Free Trade area. This proposal, introduced by Senator Phil Gramm and Congressman Jack Kemp, calls for a North American Free Trade Area that would include the U.S., Canada, Mexico, and the Caribbean Basin Initiative participants. This agreement would be reciprocal and provide for mutual reductions in trade barriers to promote trade, economic growth, and employment throughout North America. The Gramm-Kemp approach would provide strong incentives for other countries to negotiate reductions in trade barriers with the U.S. or face increased competition from those countries which do.

In order to realize these important benefits, we must not yield to the temptation to dilute the free trade agreement with single sector protectionism. Protection of a single industry always comes at the expense of the overall economy. A recent study by Arthur Denzau at the Center for the Study of American Business shows "that if the United States had imposed a 15 percent import quota on steel in 1984, as the steel industry sought, 26,000 steelworkers jobs could have been saved -- but at the cost of 93,000 jobs in the steel using industries. High prices for protected domestic steel would have made American automobile and durable goods producers less competitive." Moreover, the American consumer would pay much more in the form of higher prices for these goods than the wages earned in the jobs that would have been saved. The cost-benefit ratio in the case of footwear quotas was 9:1; in the case of steel and autos, 4:1.

Accordingly, ITC recommends that the free trade agreement (and all other trade legislation) contain a statement detailing the economic impact on and costs to the U.S. consumers as outlined in the Gramm/Kemp proposals for a North American Free Trade Area.

Most importantly, a free trade agreement should include agricultural services, investment and intellectual property rights to serve as a model for the more difficult and important ongoing General Agreement on Tariffs and Trade (GATT) negotiations. America blocked the formation of the International Trade Organization in the 1940's and effectively fought to remove agriculture from GATT rules in the 1950's. As a result, U.S. service companies and multinationals now face a "hodge podge" of rules governing trade in services and investment which vary from country to country. American farmers have lost tremendous markets to subsidized European agriculture due to this lack of GATT restrictions.

The free trade agreement should include a commitment to end the use of public subsidies and dumping in all sectors of the economy by the year 2000. This is similar to the U.S. approach recently set forth through recent GATT negotiations on agricultural policy. Subsidies and dumping encourage the use of countervailing duties and quotas by countries with competing industries. The net effect of this is the taxing of the many for the benefit of the few,increasing the cost of goods to consumers, reducing the creation of jobs and diverting the flow of investment capital to inefficient producers.

The International Trade Council proposes that a moratorium on countervailing duties and quotas be declared. The International Trade Commission and its counterpart, the Canadian Import Tribunal should be phased out and replaced with a joint panel to resolve unfair trade practices.

If we fail to establish a bilateral mechanism to resolve these disputes, American businesses and farmers could be further burdened by unilateral retaliation by Canada and other countries adopting the U.S. argument in the Canadian softwood lumber case that discretionary administration of public resources constitutes a subsidy. Under our own logic, the use of state industrial development bonds, government financed irrigation projects, pollution control easements or antitrust laws or antitrust exemptions by U.S. exporters could justify a foreign countervailing duty.

The status quo in trade with Canada and the rest of the world cannot be maintained, nor can we solve the problems through more quotas, stiffer tariffs or higher barriers. Retaliation breeds retaliation and American consumers and workers pay the price for "getting tough." The ongoing free trade negotiations with Canada offer a great opportunity to reverse this vicious cycle with reductions in trade barriers, creating incentives for other countries to join in or be squeezed out of the North American market.

STATEMENT OF J. I. CASE COMPANY
IN SUPPORT OF THE
UNITED STATES-CANADA FREE TRADE AGREEMENT

J. I. Case Company ("Case") favors prompt implementation of the United States-Canada Free Trade Agreement. Case is a $3.7 Billion manufacturer of agricultural and construction equipment employing approximately 30,000 persons worldwide. It has manufacturing and distribution facilities throughout the United States, and in Canada. Transnational shipments of parts and wholegoods between these countries during 1987 reached close to $600,000,000. As a result, implementation of the proposed trade pact will have a profound impact on Case.

Trade in agricultural equipment between the United States and Canada is already duty-free, and the trade agreement would maintain this arrangement which has proved so valuable to Case. More importantly, the trade agreement would result in the complete elimination of tariffs on the type of construction equipment that Case markets. The staged reduction of these tariffs, which are relatively high in Canada, would take place over 5 years; and though we would prefer more immediate elimination, we accept the need for such a phase-out period in view of the legitimate concerns of both countries.

There are many other aspects of the proposed trade pact that Case supports. For instance, the country of origin rule requiring products to contain at least 50% domestic content will allow Case to compete more effectively against non-FTA companies and will stimulate use of its domestic production.

The United States-Canada Free Trade Agreement represents an historic achievement which we believe will greatly benefit both countries. Consequently, we urge the United States Senate Committee on Finance to expedite preparation of the necessary implementing legislation and act favorably on it once completed.

Submitted on behalf of

J. I. CASE COMPANY

By: David B. Falstad
Senior Vice President,
General Counsel & Secretary

STATEMENT OF JOSEPH E. SEAGRAM & SONS, INC.

This statement is submitted on behalf of Joseph E. Seagram & Sons, Inc. (Seagram) in response to the Committee on Finance press release of February 23, 1988 requesting comments on the United States-Canada Free Trade Agreement (CFTA).

Summary

Seagram appreciates the invitation of the Senate Committee on Finance to comment on the CFTA. Free trade between the United States and Canada would be an important accomplishment for our country and for world trade generally. Seagram would like to do its part to make sure that this historic agreement becomes a reality.

We believe that extensive benefits will be derived from the more balanced and improved trade with Canada that would occur if the CFTA becomes operative. Seagram therefore urges Congress to approve legislation implementing this agreement.

In Seagram's view, the elimination of tariff barriers is the cornerstone of any fundamental free trade agreement. Seagram applauds the success with which U.S. and Canadian negotiators were able to agree on the elimination of tariffs for nearly all products traded between the two countries. Seagram believes that these accomplishments merit Congressional approval.

Seagram's Operations and Interests

Seagram is a New York-based corporation which is the leading manufacturer and marketer of distilled spirits and wines in the United States. We employ over 3,800 people throughout the United States representing 75% of all our North American employees. The company owns three distilleries and bottling plants, two in Maryland and one in Indiana. Seagram also owns one of Napa Valley's most distinguished wineries, Sterling Vineyards, as well as The Monterey Vineyard.

Joseph E. Seagram & Sons, Inc. is the principal operating subsidiary of the Canadian corporation, Seagram Company Ltd., which is based in Montreal. However, with affiliates in 27 countries, Joseph E. Seagram & Sons, Inc. directly manages the corporation's European and other international operations through our New York offices. Seagram and its affiliates produce and market more than 700 brands of distilled spirits, wines, champagnes, ports and sherries in more than 150 countries. However, the United States and Canada account for 54 percent of the company's total spirits and wine revenues.

Both in the United States and Canada, the products of Seagram and its affiliates are subject to substantial customs duties and excise taxes. Moreover, spirits and wine are subject to additional taxation by governmental subdivisions within the countries in which Seagram and its affiliates products are sold.

Seagram supports the balanced package of duty reductions contained in the CFTA. These reductions will encourage additional trade between the two countries and contribute to needed economic growth. Seagram is particularly pleased that agreement was reached that will eliminate entirely the tariffs on distilled spirits (item number 2208.30) effective January 1, 1989, if Congressional and Parliamentary approval of the CFTA is obtained.

The Importance of the CFTA

In Seagram's view, the implementation of the CFTA is in the best interests of the United States and Canada. The United States and Canada are major trading partners, and both have prospered over the years as a result of this partnership. By establishing a more balanced and open trade relationship between the United States and Canada, the CFTA is an important step in strengthening the world's trading system. For while the immediate trade benefits of the CFTA are of interest to Seagram, we also recognize that the conclusion of this agreement gives additional momentum to future agreements, i.e., the Uruguay Round of Multilateral Trade Talks and the European Communities' agreement on corporate taxation harmonization.

Seagram is dedicated to the goal of free trade. We acknowledge, of course, that there will be times when Seagram is a direct beneficiary of a more open trading system; but there will also be instances when our competitors reap the primary benefits. Of overall importance, however, is the one undeniable fact that free trade benefits all countries over the long term.

Implementation of the CFTA would increase the efficiency of the North American economies and strengthen each country's ability to export into an increasingly competitive world market. Such a partnership would demonstrate a strong North American commitment to free and fair trade, and serve an exemplary role in the Uruguay Round for resolving major trade issues through negotiation rather than confrontation.

Free trade between the United States and Canada has often been a subject of discussion; however, the two countries have never come this close to achieving agreement. Seagram believes that the two countries should take full advantage of this opportunity to strengthen their ties. If the occasion is missed, it will undoubtedly take many years to build enough momentum to revisit the idea of North American free trade.

Seagram has long endorsed policies which foster free, fair, and open trade throughout the world, because history has proven that free and fair trade creates the greatest well-being for not only the United States, but for all countries. Accordingly, Seagram has supported such beneficial legislation as the Caribbean Basin Initiative and the Israeli Free Trade Agreement. Seagram believes that the CFTA will facilitate more balanced, open trade with Canada and will yield similar, beneficial results for both countries in particular and for world trade generally.

Conclusion

Because of the extensive benefits that U.S. industries and consumers will derive from the more balanced and improved trade that the CFTA would foster, Seagram urges Congress to support legislation to implement this important agreement. Should we be able to provide any specific information or answer any further questions regarding the CFTA, we would be pleased to do so.

Respectively submitted,

JOSEPH E. SEAGRAM & SONS, INC.

John J. Salmon

By: John J. Salmon
Counsel for
Joseph E. Seagram & Sons, Inc.
Dewey, Ballantine, Bushby,
Palmer & Wood
1775 Pennsylvania Avenue, N.W.
Washington, D.C. 20006

UNITED STATES BEET SUGAR ASSOCIATION
1156 FIFTEENTH STREET, N.W.
WASHINGTON, D.C. 20005
(202) 296-4820

March 25, 1988

Ms. Laura Wilcox
Hearing Administrator
205 Senate Dirksen Office Bldg.
Washington, D.C. 20510

Dear Ms. Wilcox:

This letter is in response to the solicitation for written comments on the United States/Canada free trade pact.

The comments concern proposed Article 707: "Market Access for Sugar-Containing Products," which states: "The United States of America shall not introduce or maintain any quantitative import restriction or import fee on any good originating in Canada containing ten percent or less sugar by dry weight for purposes of restricting the sugar content of such good."

We believe the proposed exemption of products containing 10 percent or less sugar from future United States import restrictions, irrespective of their impact on the United States sugar program, is unwarranted.

Since the adoption of sugar import quotas in 1982, imports of sugar-containing products from Canada have increased at an alarming rate. It is obvious that these imports are circumventing the quota program.

Canada produces approximately 120,000 metric tons of sugar annually, which is equal to about 10 percent of its annual consumption. Thus, its shipment of sugar-containing products to the United States is made possible only by the use of imported sugar. There is no good reason to afford products imported into Canada with preferential treatment as transshipped products to the U.S.

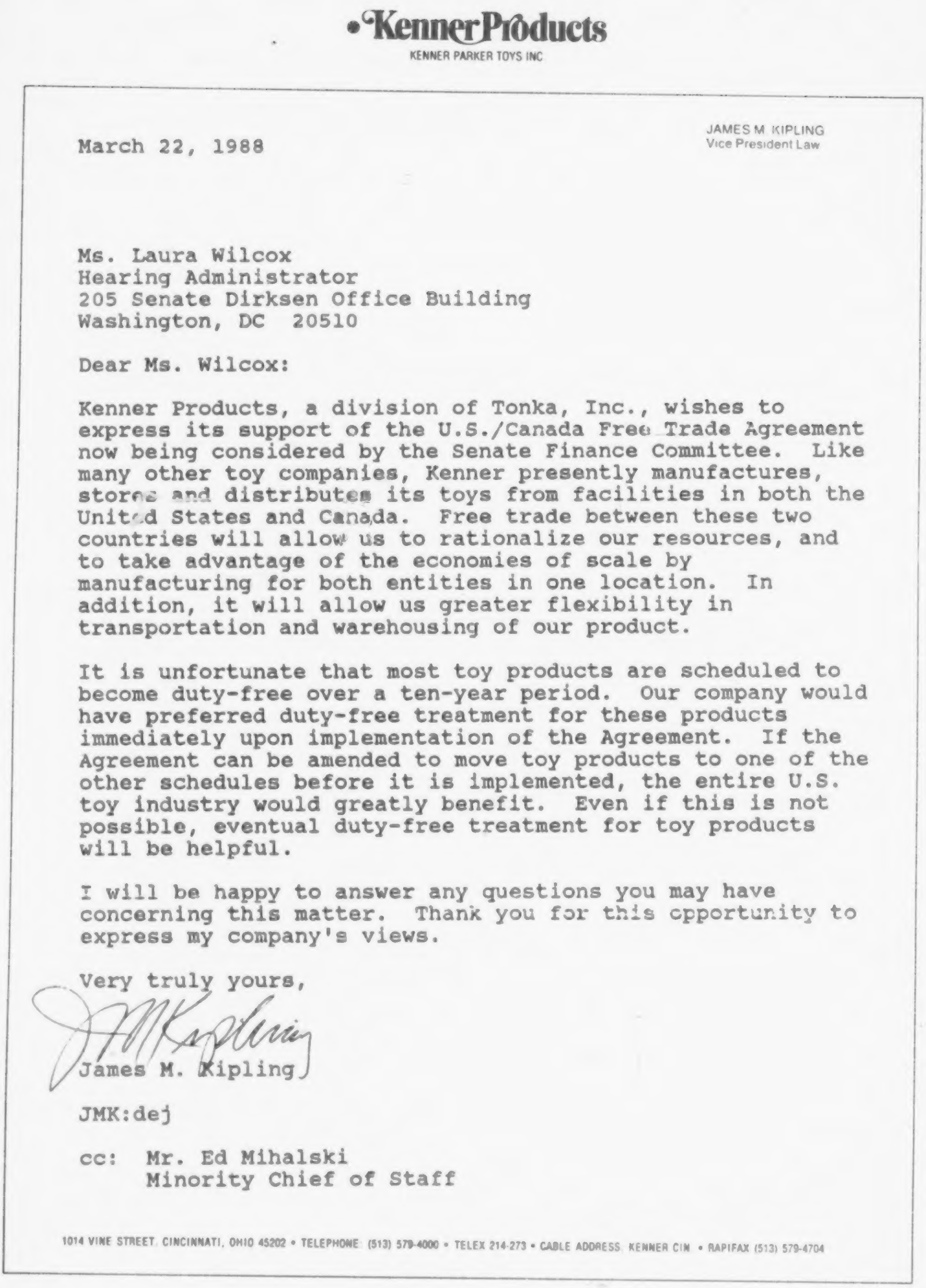
In order to rectify the inequity already written into the pact, we respectfully urge that the sugar in the exempt products be produced from Canadian sugar beets.

Thank you.

Sincerely,

David C. Carter
David C. Carter, President
U.S. Beet Sugar Association

Nicholas Kominus
Nicholas Kominus, President
U.S. Cane Sugar Refiners' Association



Kenner Products
KENNER PARKER TOYS INC

JAMES M. KIPLING
Vice President Law

March 22, 1988

Ms. Laura Wilcox
Hearing Administrator
205 Senate Dirksen Office Building
Washington, DC 20510

Dear Ms. Wilcox:

Kenner Products, a division of Tonka, Inc., wishes to express its support of the U.S./Canada Free Trade Agreement now being considered by the Senate Finance Committee. Like many other toy companies, Kenner presently manufactures, stores and distributes its toys from facilities in both the United States and Canada. Free trade between these two countries will allow us to rationalize our resources, and to take advantage of the economies of scale by manufacturing for both entities in one location. In addition, it will allow us greater flexibility in transportation and warehousing of our product.

It is unfortunate that most toy products are scheduled to become duty-free over a ten-year period. Our company would have preferred duty-free treatment for these products immediately upon implementation of the Agreement. If the Agreement can be amended to move toy products to one of the other schedules before it is implemented, the entire U.S. toy industry would greatly benefit. Even if this is not possible, eventual duty-free treatment for toy products will be helpful.

I will be happy to answer any questions you may have concerning this matter. Thank you for this opportunity to express my company's views.

Very truly yours,

James M. Kipling

JMK:dej

cc: Mr. Ed Mihalski
Minority Chief of Staff

1014 VINE STREET, CINCINNATI, OHIO 45202 • TELEPHONE (513) 579-4000 • TELEX 214-273 • CABLE ADDRESS: KENNER CIN • RAPIFAX (513) 579-4704

Statement
# of the
Maritime Coalition
on the
U.S.-Canada Free Trade Agreement
before the
Senate Finance Committee
March 17, 1988

The ad hoc Maritime Coalition on the U.S.-Canada Free Trade Agreement, representing a broad spectrum of U.S. ship operating and shipbuilding industries, appreciates the opportunity to comment on the recently negotiated U.S.-Canada Free Trade Agreement (FTA). Although many of the Coalition's concerns were alleviated when the Transportation Annex was deleted from the FTA, a few unresolved concerns remain. It is understood that the FTA cannot be renegotiated or changed substantially at this time. However, we are hopeful that careful drafting of the implementing legislation can minimize potential negative consequences for the U.S. maritime industry.

As the Committee is probably aware, the Coalition vigorously opposed the inclusion of maritime services within the proposed Transportation Annex to the Services Chapter of the FTA. Fortunately, after protracted efforts by the Coalition, its individual members and a bipartisan majority of both houses of Congress, the entire Transportation Annex was excluded from the FTA.

Both President Reagan and U.S. Trade Representative Yeutter have stated their desire to use the FTA as a role model for the Uruguay Round of General Agreement on Tariffs and Trade (GATT) negotiations. We can only hope they intend to use it as it is currently written -- without maritime transportation covered under a services agreement. And also without allowances for the export of domestic petroleum rescurces.

With respect to the remainder of the FTA, the Coalition is concerned about several provisions, particularly the mandatory annual review or rollback provision, the possible future expansion of the Government Procurement Chapter to include services, the uncertain application of the Tourism Annex to waterborne passenger transportation, the export of Alaska North Slope (ANS) oil, and the impact of the repeal of the U.S. Customs ad valorem duty on non-emergency ship repairs in Canadian yards.

The Coalition fears that the interpretation the U.S.-Canada FTA objective listed in Article 102(e), "to lay the foundation for further bilateral and multilateral cooperation to expand and enhance the benefits of this Agreement," may eventually lead to the inclusion of maritime and maritime-related services in the future. The Coalition has opposed this possibility from the very beginning of these negotiations. Maritime services are essential to national security, as well documented by the recent reports of the presidentially-appointed Commission on Merchant Marine and Defense, and must not be decimated under the guise of free trade, now, or in the future.

The objective of the Government Procurement Chapter, stated in Article 1301(1), is to expand trade opportunities in government procurement "for the supply of goods and services." Currently, the FTA only covers the purchase of various goods. However, it is conceivable that this Chapter could be expanded to include services, especially considering Article 1307, which specifically requires the two nations to undertake additional negotiations within one year to expand the provisions of the Chapter. The Coalition is adamant in its opposition to the possible future expansion of this Chapter to the government procurement of services, particularly maritime services. The U.S.-flag merchant fleet is highly dependent on government contracts for its survival. In addition, the Coalition opposes, on national security grounds, the possible granting of national treatment to Canadian or any other foreign citizens which would allow them to compete for Military Sealift Command charters.

Another issue of concern to the Coalition is the interpretation of the Tourism Annex to the Services Chapter. There appears to be some inconsistency in the Annex language that could be detrimental to the U.S.-flag shallow-draft passenger vessel fleet. Within the Annex, tourism services includes all modes of international passenger transportation and local sightseeing, regardless of the mode of transportation. However, the Annex also states that it does not confer rights or impose obligations relating to transportation services that are not otherwise conferred or imposed elsewhere in the Agreement. Since the Transportation Annex was specifically excluded, this Annex has created uncertainly among U.S. and Canadian tour boat and small passenger vessel operators. Therefore, we urge that the implementing legislation be carefully worded so as not to impinge upon our nation's coastwise laws.

The Coalition also takes issue with Annex 902.5 within the Energy Chapter of the Agreement. Particularly, we oppose the export measure which "exempts Canada from the prohibition on the exportation of Alaskan oil under section 7(d) of the Export Administration Act of 1979, as amended, up to a maximum of 50,000 barrels per day." Industry analysis has determined that this provision will harm U.S.-flag tanker and shallow-draft liquid bulk operators. This will result in the loss of militarily useful tankers and trained crews necessary for national defense purposes. It is also contrary to repeated expressions of Congressional opposition to the export of secure domestic energy supplies. This is evermore important since the U.S. Geological Survey has recently reduced its estimates of undiscovered domestic oil and gas reserves by 40 percent.

Furthermore, this provision establishes a dangerous precedent for future negotiations which threatens the nation's energy independence and national security. Since the U.S.-Canada FTA has been touted as a role model for GATT negotiations and a possible FTA with Japan, other U.S. trading partners may seek similar access to our domestic oil supplies. Therefore, the Coalition urges that the implementing language follow the oil swap mechanism established by section 7(d) of the Export Administration Act with an overall oil export ceiling of 50,000 barrels per day to Canada and emphasize that this allowance is a unique provision designed for Canada only.

With these concerns in mind, the Coalition respectfully urges you to seek precise implementing language in the context of the U.S.-Canada FTA that will reinforce the exemption of maritime services from the current agreement and subsequent bilateral and multi-lateral agreements and will prohibit the export of domestic petroleum supplies in any future bilateral or multi-lateral agreements.

STATE OF MINNESOTA
OFFICE OF THE GOVERNOR
ST. PAUL 55155

April 7, 1988

The Honorable Lloyd M. Bentsen
Chairman
Committee on Finance
U.S. Senate
219 Dirksen Senate Office Building
Washington, D.C. 20510-6200

Dear Senator Bentsen:

As you know the proposed Canada-U.S. Free Trade Agreement is a strong step toward trade liberalization between the world's two largest trading partners. As a border state with significant Canadian heritage, Minnesota well understands the importance of this trade relationship.

Initial review of the proposed changes shows that a free trade agreement with Canada will impact favorably on Minnesota. The elimination of tariffs on high technology products, some as high as 17 percent, will certainly benefit Minnesota companies. Secure access to Canadian hydroelectric power, Minnesota's main import from Canada, will be important to our future economic growth and well being.

With the projected net benefits to Minnesota's economy, and as an advocate of free and fair trade, I am strongly supporting this agreement. Whereas I hope that further steps can be taken in the agricultural area in future negotiations, we all must recognize the importance of this legislation and the benefits it will bring.

I am submitting for the record an article written by the Commissioner of our Department of Trade and Economic Development. This article was presented as our official position statement at the Durenberger-Frenzel congressional hearing on the Canada-U.S. Free Trade Agreement held in Minneapolis on November 11, 1987. I would like this statement of Minnesota's support to be submitted for the official transcript of the U.S. Senate Committee on Finance proceedings.

Sincerely,

Rudy Perpich

RUDY PERPICH
Governor

FREE AND FAIR TRADE

A STEP TOWARD FUTURE PROSPERITY

By David J. Speer
Commissioner
Minnesota Department of Trade and Economic Development

The free trade agreement struck last month between the United States and Canada was a significant event in the history of international trade. In the face of our growing trade deficit, we must recognize the importance of the U.S.-Canada free trade agreement to our future economic well being.

The United States and Canada constitute the world's largest trading partnership. Trade between the two countries totaled $125 billion in 1986, more than Japan and only slightly less than trade between the United States and all 12 member nations of the European Community. Significantly, this trading relationship accounts for 24 percent of all U.S. exports and 70 percent of all Canadian imports.

An improved trade relationship with Canada will certainly benefit Minnesota. Minnesota's bilateral trade with Canada last year totaled $3.0 billion, of which almost $1 billion represented Minnesota exports. This means that 40,000 Minnesota jobs are tied directly or indirectly to this trade relationship. One-third of Minnesota's foreign investment has come from Canada, compared to 18 percent nationally. This has created another 11,000 jobs in our state.

Minnesota business has been active in support of the free trade initiative. There are 15 Minnesota members of the American Coalition for Trade Expansion with Canada (ACTE/CAN), a nonprofit organization representing a wide variety of business interests. Several of our state's largest corporations are represented, as are smaller companies such as Perham Egg, and Claseman Management Services, which represents 1,100 small businesses throughout the region; 800 of them in Minnesota.

Credible studies on both sides of the border conclude that the U.S. and Canada will receive significant economic stimulus from free trade. Among these are a national study done by the Economic Council of Canada and a regional study done by the 49th Parallel Institute at Montana State University. Economic analysts speak of boosts in real wages, increased production, stimulated business investment and industrial revitalization.

These potential benefits precisely reflect the type of economic reform advocated by The Business Roundtable in its June report entitled "American Excellence in a World Economy." The Roundtable report calls for increased productivity and cites competition as a taskmaster in that quest. It states that we must resist the temptation to "justify misguided policies designed to 'help' American industries compete in world markets." Protectionism is simply the other side of the free trade coin.

The report goes on to say that the United States must do better in world competition. By offering expanded market opportunities, sometimes competitive in nature, the U.S.-Canada free trade agreement gives us a chance to do just that. One step at a time, starting with Canada.

As with all trade negotiations and their resulting impact on various industrial sectors and special interest groups, there are advocates and opponents. And, as expected, the opponents tend to be more vocal. But it is important to note here that we are not calling for sweeping reform. More than 80 percent of trade between the U.S. and Canada is already duty free, and a significant portion of the remainder has a tariff of less than five percent.

With that in mind, let's look at two areas of opposition to the free trade agreement: energy and agriculture.

On the energy side, free and open energy trade would be established between the two countries. The United States would have access to Canadian energy in a time of scarcity and more Canadian hydro power would be sold southward. On our side of the border, there is opposition from states with coal and petroleum resources.

Let's look at the broader picture from the U.S. side. Minnesota, for example, currently imports almost $90 million per year of Manitoba hydro power. The enormous James Bay hydro electricity project in Quebec exports a significant amount of energy to northeastern states. Hydro power is plentiful, environmentally sound, and is generated from a renewable resource. It's a sound example of comparative advantage, and Americans reap the benefits in a number of ways. One is in affordable energy for our homes and businesses (the cost of electricity in Minnesota is among the lowest in the nation). Another is that we are consuming electricity produced by a non-polluting source, an argument which pays for itself in spades on the acid rain issue.

In Canada the opposition comes from those who hold that Canada is surrendering its right to decide unilaterally how it will administer its energy resources in times of scarcity. But the provision for shared energy in times of scarcity already exists for oil supplies through the International Energy Accord, to which Canada is committed.

The bottom line is that Canada will be a reliable supplier if the U.S. is a reliable customer. Given all the benefits, it is difficult to argue with the logic of having this kind of relationship with our neighbor to the north.

In the agricultural area, there are pockets of opposition on the U.S. side. Among them are the hog producers, meat packers, and corn producers, where the impact of market changes can be particularly sensitive. But we have negotiated improved market access in the area of processed foods which will benefit our food processors across the board. These are companies large and small, with new potential for job creation in value-added manufacturing areas to help stabilize our rural economy.

Additionally, both countries retain their right to apply countervailing duty and anti-dumping laws. This means that justifiable protection can still be accorded to agricultural producers. Existing countervailing duties on hogs and corn will remain in place. This is a very important component of the proposed agreement. It recognizes sensitive issues and deals with them fairly.

The most important part of the agricultural section of the free trade agreement text, however, foreshadows what is the most significant, yet seldom discussed component of the agreement. The two countries have agreed that their primary goal is to achieve, on a global basis, the elimination of all subsidies which distort agricultural trade. We would work together to achieve this goal. This strategy would include multilateral trade negotiations, such as the Uruguay Round of the GATT.

This is important. The rest of the world is watching the progress of our proposed trade agreement with Canada because it will make a strong statement about what can be expected of us in coming years in the area of trade liberalization. It predicts how the United States and our bilateral trading partner will approach free and fair trade in the future, working together as a stronger force in multilateral negotiations.

In summary, we have two unusual opportunities here. First is the chance to enhance our trade relationship with Canada and practice adjusting to trade liberalization changes. Second, and perhaps more important, is the chance to send a powerful signal for well conceived trade liberalization and against protectionism that will serve our two countries well in future trade negotiations.

Our role at the state government level is to make sure the fundamental issues at stake in the U.S.-Canada free trade agreement are not missed. We must spread the word that what is proposed is free and fair trade, not an open market free-for-all. What we are promoting is a very thoughtfully drafted "contract" with our best trading partner and a strong step in the direction of global free and fair trade.

On the U.S. side, the agreement will be signed by President Reagan in early January, and it will then be up to Congress to decide its fate. But Americans of all political stripes are generally open to intelligent arguments well made, and there are compelling ones tied up in this agreement. This pending legislation deserves our support.

-END-

MOTOR & EQUIPMENT MANUFACTURERS ASSOCIATION

PREPARED STATEMENT REGARDING THE IMPACT OF U.S.-CANADA FTA ON THE U.S. MOTOR VEHICLE PARTS MANUFACTURING INDUSTRY

Submitted to the

SENATE COMMITTEE ON FINANCE

March 24, 1988

The Motor and Equipment Manufacturers Association (MEMA) appreciates the opportunity to present its views to the Senate Committee on Finance regarding the impact of the U.S.-Canada Free Trade Agreement (FTA) on the U.S. motor vehicle parts manufacturing industry.

MEMA, founded in 1904, is the oldest continuous trade association in the motor vehicle industry. Today, MEMA is the trade association representing and serving the interests of U.S manufacturers of motor vehicle parts and components, accessories, chemicals and compounds, and related equipment.

Canada is by far our largest export customer, importing more than $13 billion worth of U.S. motor vehicle parts and accessories in 1986. In turn, the United States imported over $9.4 billion in parts and accessories from Canada in 1986. Based on part-year data, this trend continued in 1987.

U.S. export data, which are subject to undercounting, show a less favorable pattern of trade when combined with U.S. import data, but still indicate a very healthy bilateral parts trading relationship. It is in the interests of both countries that this relationship continue to prosper.

The FTA contains some positive features for our industry, including a phased reduction of Canadian tariffs on replacement parts for motor vehicles and the elimination in 1989 of Canada's duty remission on exports to the United States.

On balance, however, the FTA is a major disappointment for the U.S. motor vehicle parts industry. We do not believe it will do much to promote the long-term international competitiveness of the U.S. motor vehicle parts industry. Moreover, we lost a very good opportunity during the final stage of the negotiations to develop a much better agreement.

Provisions affecting automotive trade, which accounts for one-third of total U.S.-Canada trade, are a central part of the overall agreement. They therefore deserve very close scrutiny by all members of this Subcommittee and the full Congress.

While no industry should expect the FTA to address all of its concerns, this agreement has a critical shortcoming: **the rule of origin which will determine eligibility for tariff reductions on motor vehicle and parts trade covered by the FTA.** The agreement includes only a 50 percent requirement, rather than the 60 percent level recommended by a very broad cross-section of U.S. and Canadian parts and vehicle manufacturers.

During hearings before the House Trade Subcommittee on February 9, Ambassador Yeutter confirmed that the U.S. Government offered, and the Canadian Government rejected, a 60 percent rule of origin. We continue to question the political and economic wisdom of this decision, and hope future discussions between our governments will reverse the mistake.

By rejecting a 60 percent rule of origin, Canada shortchanged vehicle parts producers throughout North America. The 50 percent rule in the FTA is inadequate, because it does not sufficiently promote the long-term competitiveness and prosperity of U.S. and Canadian parts manufacturers.

Justification for a 60 percent rule of origin

We believe a stronger rule of origin is essential to make the FTA a useful agreement from the standpoint of the U.S. parts manufacturing industry. Our industry is quite diverse, but is broadly unified behind achieving a 60 percent rule of origin.

There are several reasons why a 60 percent rule of origin is so important to U.S. parts manufacturers.

First, it would encourage a more rapid increase in purchases from U.S. parts suppliers by Japanese, Korean, and other third-country vehicle producers. In particular, it would give these producers greater long-term incentives to expand purchases of U.S.-made engine, transmission, and other high-value-added, advanced technology components.

This business is of strategic importance to U.S. parts manufacturers who are trying to develop long-term commercial relationships with manufacturers of foreign-brand vehicles in North America and overseas. As so-called "foreign transplant" vehicle production grows in North America, U.S. parts manufacturers must get their foot in this door or risk a serious decline in overall sales.

It is important to note that a 60 percent rule of origin is consistent with the announced plans of these transplant manufacturers to expand investment and purchases in North America. We think it will accelerate progress in this direction, by reinforcing the economic signals provided by more favorable dollar exchange rates.

Second, a 60 percent rule of origin also would foster more procurement by traditional North American vehicle producers from U.S. and Canadian rather than third-country parts manufacturers. This proposal would not jeopardise the international competitiveness of U.S. Big Three producers or their Canadian counterparts, which accepted it as a reasonable requirement for the agreement during the final stages of the FTA negotiations.

Third, a stronger rule of origin would partially offset existing incentives to increase use of third-country components, such as foreign-trade zones, the GSP program, tariff provisions 806/807, and multilateral duty-free sourcing privileges which Auto Pact members in Canada will retain indefinitely under the terms of the FTA.

Finally, a 60 percent North American rule of origin would improve the long-term balance in U.S. and Canadian benefits from the FTA, in view of continuing Canadian Auto Pact safeguards and only gradual phase-out of Canadian duty remission schemes.

MEMA recognizes that there are other provisions in the FTA affecting the U.S. motor vehicle parts industry which are of concern or fall short of original expectations.

We have chosen to emphasize the need for a 60% rule of origin because we believe it has greater commercial value to U.S. parts manufacturers, particularly over the longer term, than other changes which have been proposed. These other suggested changes include elimination of Canada's Auto Pact safeguards and a more rapid phase-out of its remaining duty remission programs.

Beginning in January 1989, all U.S. imports of motor vehicles and parts from Canada will be subject to the rule of origin requirements of the FTA. U.S. Auto Pact members will continue to be eligible for duty-free treatment if they meet the revised rule of origin in the FTA. Assemblers of foreign-brand vehicles in both the United States and Canada will be required to meet the same rules of origin to benefit from the phased elimination of bilateral tariffs under the FTA.

Thus, a stronger rule of origin provision is essential to ensure short- as well as long-term benefits to U.S. producers from the agreement.

In conclusion, MEMA urges this Committee and other members of Congress to take an active interest in improving the automotive provisions of the FTA. The United States and Canada both have a very great stake in ensuring that the FTA promotes a healthy, efficiently integrated North American parts production base and expanding market for automotive products.

The FTA currently does not move far enough in this direction. If approved in its present form without a clear statement of U.S. Government intent to seek near-term improvements, Canada is unlikely to work with us to make necessary changes.

If Canada remains unwilling to modify its position on a 60 percent rule of origin before the FTA takes effect, we urge Congress to provide language in implementing legislation to require further bilateral consultations to seek this objective. Such discussions should begin as soon as possible after the FTA comes into force.

Section 1004 of the FTA provides a possible framework for both future industry-to-industry and government-led consultations to refine the Agreement.

This section calls for the establishment of a "select panel" of experts to examine evolving conditions within the North American motor vehicle industry and propose public policy measures and private initiatives to improve its competitiveness. The FTA does not, however, provide guidance regarding the composition of this panel, its agenda, or a timetable for discussions.

At a minimum, we believe Congress, though FTA implementing legislation, should provide a clear mandate for this select panel. We recommend that the panel be given a one-year (January 1990) deadline for completion of initial recommendations to the President concerning ways to enhance the automotive provisions of the FTA. A stronger North American rule of origin should be identified by Congress as one of the principal issues for its review.

In addition, and of equal importance, we propose that Congress grant the President authority to strengthen the rule of origin provisions in the FTA through administrative action if Canada consents to such a change. We understand that the Canadian Government already has the authority to make this type of modification by regulation.

Adoption of a 60 percent North American rule of origin will greatly expand the benefits of the FTA to the U.S. motor vehicle parts industry and will broaden support for the agreement. MEMA urges further efforts by the Administration and Congress to achieve this important objective.

National Association of Wheat Growers
415 Second Street, N.E., Suite 300, Washington, D.C. 20002, (202) 547-7800

March 25, 1988

Honorable Lloyd Bentsen
Chairman
Senate Committee on Finance
Washington, D.C. 20510

Dear Mr. Chairman:

Pursuant to the Committee's call for written comments to accompany its March 17 hearing on the U.S.-Canada Free Trade Agreement, the National Association of Wheat Growers respectfully requests that this letter be made a part of the record. We commend the Committee for its timely and thorough consideration of the FTA, especially at a time when your other pressing business puts time at such a premium.

Wheat farmers have had serious concerns about some particular provisions of the FTA. Briefly, we believe there is a lack of balance in the Agreement's wheat provisions that raises serious questions whether the FTA might put U.S. farmers at a substantial and unnecessary disadvantage, vis-a-vis farmers in Canada. Specifically, we question the wisdom of an agreement that allows the Canadian border to remain, in the short term, essentially closed to imports of wheat or products of wheat, until "support levels" are equalized based on a formula whose methodology is, to say the least, controversial. We also believe it is unfortunate that U.S. negotiators agreed to allow Canadian rail transportation subsidies to remain in place for shipments of grains through Thunder Bay (similar subsidies will be eliminated for shipment through western ports, but wheat generally does not move from Canada to the U.S. by this route). Finally, it would appear that new obstacles to the use of Section 22 import restraints are raised by the FTA, inasmuch as a new condition for such restraints (a significant increase in imports as a result of a substantial change in the support programs of either country) is introduced .

If the FTA is approved, it seems to us that control over the volumes of Canadian wheat shipped to the U.S. will be largely in the hands of the Canadian Wheat Board, the quasi-government monopoly that controls exports of that country's wheat. This is the case because the CWB has the power to utilize transportation subsidies and differential pricing, and change the status of export permits so that, for instance, individual Canadian farmers might be authorized to export into border states. In addition, the restraining influence of the U.S. Section 22 import law, which has not been invoked for many years but whose presence in U.S. law has acted as a brake on surges of Canadian shipments, could be less a factor under the FTA.

To some degree, the effects of the FTA are speculative because of considerable ambiguity in some portions of the final text. There is, for example, no firmly agreed interpretation of the precise manner in which the Section 22 provisions would be administered, so far as we can tell.

We believe there are significant possibilities for clarifying this and certain other ambiguities in the implementing legislation and in legislative history. We have met with officials of the Administration to suggest ways in which such clarification could occur without in any way violating the final text of the Agreement. These discussions continue, and in the same way we have presented our ideas to the staff of the Committee for their consideration.

We would welcome the opportunity to talk further about these matters with you or your staff, or to provide any further information that might be useful. With thanks for your consideration, I am

Sincerely,

Frank Johannsen
President

STATEMENT

of the

NEW ENGLAND FUEL INSTITUTE
and the
INDEPENDENT FUEL TERMINAL OPERATORS ASSOCIATION

Washington, D.C.
April 22, 1988

The New England Fuel Institute ("NEFI") and the Independent Fuel Terminal Operators Association ("IFTOA") hereby submit this statement to the U.S. Senate Committee on Finance concerning the energy provisions of the U.S.-Canada Free Trade Agreement. NEFI is an association of more than 1,300 independent fuel oil marketers throughout New England. These firms own no crude oil production, refineries or pipelines. Many are small and family run enterprises. Together, they deliver more than 86 percent of the No. 2 home heating oil delivered in New England at the retail level and 85 percent at the wholesale level. IFTOA is an association of 19 companies which own and control petroleum product terminals from Maine to Florida capable of receiving ocean-going tankers. None is affiliated with a major integrated oil company. Members of the Association are also independent marketers of No. 2 fuel oil, No. 6 fuel oil, gasoline and other petroleum products.

I. Introduction

NEFI and IFTOA (collectively the "independent marketers") generally support the principles of free trade and the concepts embodied in the U.S.-Canada Free Trade Agreement ("FTA"). However, this Agreement was negotiated under extreme time pressures and, in certain respects, without regard to the implications of some of its provisions on American companies and consumers. As marketers we are specifically concerned about the effects of the provision that would exempt Canada from any future U.S. oil import fee.

Although an oil import fee is opposed by this Administration and by many members of Congress, many others have proposed and endorsed the concept. In addition, the Department of Commerce is currently considering, pursuant to Section 232 of the Trade Expansion Act, whether an import fee or other restriction on petroleum imports is necessary to eliminate any threat to U.S. national security. Therefore, despite NEFI and IFTOA's strong opposition to an oil import fee, realism requires a recognition that an oil import fee at some point in the future is a possibility. Our concern is heightened by the permanent duration of the FTA.

II. The Agreement Recognizes the Likelihood of Distortions

The concern of independent marketers stems specifically from Section 907 of the FTA, which prohibits either party from maintaining or implementing a measure restricting imports of energy from the other party. As a result of this provision, if the U.S. imposes an oil import fee at any time in the future, for budgetary, trade or security purposes, Canada must be exempted. In such circumstances, Canadian exporters of petroleum products would enjoy a major competitive advantage over U.S. firms, and could flood portions of the U.S. market with products exempt from the import fee. This action could significantly injure U.S. marketers and permanently impair the competitive viability of the independent petroleum marketing sector.

The FTA recognizes that distortions may be caused by the imposition of an import fee. Section 902.4 of the FTA specifically provides that either party may initiate consultations "with a view to avoiding undue interference with or distortions of pricing, marketing, and distribution arrangements." However, the Agreement provides for no time table for resolving such interference and/or distortions through the consultation process. Moreover, consultations may not be initiated until after "either party imposes a restriction on import of an energy good". Accordingly, unless these procedures are expedited, distortions and interference will be created and could permanently impair competition in U.S. markets before any remedy is agreed to.

III. Distortions Are Likely To Occur

The likelihood of significant distortions is not remote. Both the level of any possible import fee and the current and potentially available Canadian refining capacity make possible a massive interference in Northeast energy markets.

First, oil import fees have been proposed of $5 and $10 per barrel. Even at the lower of these levels, an exempt Canadian refiner/supplier would enjoy a 12¢ per gallon competitive advantage over all other suppliers to the Northeast. Clearly, this advantage would exist over all importers of non-Canadian products. But the advantage would also exist over domestic suppliers because the import fee would increase the price of domestic crude oil by approximately the level of the fee. Therefore, costs of domestic refiners would increase to approximately the marginal cost of U.S. crude oil imports.

A wholesale price advantage of 12¢ per gallon is enormous in the competitive marketplace. Wholesale suppliers regularly operate on margins of 2 to 3¢ per gallon or less. A cost advantage of 12¢ per gallon would give Canadian suppliers the option of undercutting all other independent suppliers by a substantial amount and thereby taking market share from those suppliers, or increasing its price to the level of the suppliers affected by the import fee and reaping huge profits. More likely, a Canadian supplier would use a combination of both strategies, that is, it would substantially undercut other suppliers to the U.S. market but at the same time significantly increase its profits. This strategy would be very simple to accomplish if an import fee were imposed in the U.S. and there were no restrictions on Canadian imports.

Second, there is sufficient surplus and mothballed eastern Canadian refining capacity to permit Canadian suppliers to wreak havoc on the Northeast market. In the period January through September 1987 approximately 337,000 barrels per day of capacity in eastern Canada was not in operation. In addition, since 1981 approximately 472,000 barrels per day of refining capacity has been shut down. Without suggesting that all of this capacity could be rehabilitated, these levels demonstrate that substantial increased volumes of Canadian products could be imported into the U.S. Northeast if significant price distortions exist.[1]

IV. Recommendation: A Clarifying Statement or Understanding

Independent marketers believe that the mechanisms established in the FTA must be clarified and strengthened to avoid a result that would injure the domestic petroleum markets of both the U.S. and Canada.

IFTOA and NEFI support a clarifying statement of legislative intent or an understanding between the U.S. and Canada that defines more specifically what the consultative process included in Section 902.4 is designed to achieve if an import restriction is imposed, and how quickly a solution must be fashioned.

The consultations should be directed toward a goal of protecting competition, and with a specific time frame so that agreement is reached promptly and distortions are avoided. The goal should be to avoid any significant changes in distribution patterns that result solely from U.S. imposition of an oil import fee.

One mechanism that can avoid such distortions is a quantitative restriction on the volume of petroleum products and natural gas that can enter the U.S. on a fee free basis. Another effective mechanism is an export tax imposed by Canada, which would serve to counter the effect of the exemption from the oil import fee.

IFTOA and NEFI specifically recommend that a legislative clarification specify a period of 60 days after initiation of consultations for the parties to agree on a mutually acceptable mechanism designed to avoid competitive distortions. If the parties do not reach agreement within 60 days, a mechanism to protect competition would be established by binding arbitration, within 30 days, pursuant to Article 1806 of the FTA. Additionally, this clarification should state that consultations would begin, following a request by either party, as soon as either party considered the imposition of a restriction on imports as likely.[2] Thus, consultations would begin before the imposition of the import fee.

This clarification would direct the consultations toward a prompt and effective remedy that would avoid distortions in either country's energy markets. However, this change would not limit the flexibility of U.S. or Canadian officials participating in the consultations to arrive at an appropriate and workable remedy, that properly reflects conditions at the time.

III. Conclusion

NEFI and IFTOA are seriously concerned about the effects on Northeast U.S. energy markets resulting from the exemption of Canada from any future oil import fee. The problem is hypothetical, but not remote. It was recognized by the negotiators of the FTA, who established a consultation mechanism to avoid distortions. However, this mechanism is inadequate. The problem can be resolved within the framework of the already negotiated FTA by inclusion of a simple legislative clarification that will guarantee a timely and effective result to these consultations, which are designed to avoid distortions created by imposition of a U.S. oil import fee. The clarification would require these consultations to establish a mechanism to avoid distortions within 60 days. This clarification will help a great deal to avoid distortions in the energy markets of both the U.S. and Canada.

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[1] In January - September 1987, the total level of product imports from all of Canada was only 121,000 barrels per day.

[2] Recommend legislative language implementing the clarification is included as Attachment A.

Attachment A

LEGISLATIVE LANGUAGE PROPOSED FOR FREE TRADE AGREEMENT

Section 232 of the Trade Expansion Act, 19 U.S.C. §1862 is hereby amended by adding the following new subsection (f):

(f) If a fee is imposed on imported oil, pursuant to this section or otherwise, Canada shall be exempt subject to the provisions of Article 907 of the Canada-United States Free Trade Agreement. However, the United States shall request consultations under Article 902.4 of such Agreement to avoid distortions in pricing, marketing and distribution arrangements as soon as the U.S. Trade Representative determines that an oil import fee is likely to be imposed and, in no event, more then seven days after such action by the United States. Consultations shall be conducted expeditiously, with a view to establishing a mutually acceptable mechanism designed to avoid distortions, within 60 days. If no mechanism is agreed to within 60 days, the matter shall be referred to arbitration, pursuant to Article 1806 of such Agreement. Such arbitration shall establish a mechanism designed to avoid distortions, and protect and enhance competition, within 30 days.

PRIORITIES IN U.S. TRADE LEGISLATION

RECOMMENDATIONS OF THE NATIONAL FARMERS UNION

Submitted to the
U.S. SENATE COMMITTEE ON FINANCE
Washington, D.C., MARCH 17, 1988

On March 9, on the final day of the 86th convention of National Farmers Union held at Albuquerque, New Mexico, delegates adopted a 1988 Policy Statement in which significant recommendations were made regarding agricultural trade.

Article III, INTERNATIONAL COOPERATION AND THE FAMILY FARM, includes a Section D, Priorities in U.S. Trade Legislation, which addresses itself to the three principal trade measures which are of major consequence to American agriculture. Section D is appended as EXHIBIT A to this statement.

As you will note from examining Section D, Farmers Union believes that Trade and International Economic Policy Reform Act, H.R. 3, S. 490, S. 1420, should have the top priority and the Textile and Apparel Trade Act, H.R. 1154, should also have early attention.

Both of those measures merely seek to create a level playing field for international trade. It is demagoguery at its worst for anyone to label these "protectionist" measures. Those who do so are engaging in duplicity and, whether they acknowledge it or not, are in complicity with the giveaway of American farm markets and U.S. jobs.

The Textile and Apparel Trade Act, in fact, assures other trading partners they will share in the growth of the U.S. market.

It is the view of Farmers Union members that both the Trade Reform Bill and the Textile Bill must be approved by Congress and signed by the President before the U.S./CANADA FREE TRADE ARRANGEMENT (FTA) is taken up for consideration.

Before commenting on the provisions of the draft treaty, we need to point out that there is a fundamental error in attempting to deal on a bilateral basis with trade problems which should be handled on a multilateral level.

The underlying problem in world agricultural commerce is not access to markets, but debased prices far below any acceptable level in relation to costs of production of efficient producers. It is not possible to address the price problem in bilateral negotiations. Rather, talks need to be in a global context with producing and importing countries fairly represented.

The Farmers Union has made a close examination and careful study of the draft of the Free Trade Arrangement and we find it totally unacceptable in its present form.

As many as ten substantive changes would have to be made in the treaty and the best course therefore would be for Congress to send it back for renegotiation. Unless the suggested deletions which follow are made, the treaty should be rejected.

Our objections to the Treaty follow:

The most ill-advised and damaging provision occurs in Article 701(1) which places the U.S. Congress and the Canadian Parliament on record supporting President Reagan's proposal to phase out all farm programs in all countries within ten years.

Article 701(1) declares:

"The parties agree that their primary goal with respect to agricultural subsidies is to achieve, on a global basis, the elimination of all subsidies which distort agricultural trade, and the parties agree to work together to achieve this goal, including the multilateral trade negotiations such as the Uruguay Round."

While this statement refers to agricultural subsidies, the term is interpretted abroad in such a distorted sense that it applies to all farm programs.

Proof of that can be seen in the Treaty itself. **Annex 705.4, Schedules 1 and 2,** list U.S. and Canadian programs which presumably can be judged to be subsidies.

Schedule 1 lists the following U.S. programs:

1. Payments of the Commodity Credit Corporation.
2. CCC Storage payments, Farmer Owned Reserve and Special Producer Loan Storage Program.

3. Conservation Reserve Program.
4. Acreage Reducation Program.
5. Certificate Premiums and Discounts.
6. CCC Loan Forfeiture Benfits.
7. Price Enhancing Aspects of Government Programs, such as the Export Enhancement program.
8. Advance payments.
9. Crop Insurance Programs.
10. Government Service Programs for Agriculture, including grain inspection, research, extension services programs, irrigation programs, inland waterways programs, conservation programs, ASCS, market news, standards and grading programs and targetted export assistance.
11. CCC Commodity Loans.
12. State Budget outlays.
13. Farm Credit Programs.

Schedule 2 lists the following Canadian programs:

1. Direct payments.
2. Payments under the Western Grain Stabilization Act.
3. Payments pursuant to the Special Canadian Grains Program.
4. Stabilization Payments made by Provincial Governments.
5. Income foregone adjustments.
6. Expenditures of the Canadian Grain Commission.
7. Wheat Board Pool Deficit (wheat, oats and barley).
8. Domestic Wheat Pricing.
9. Domestic Price Gap: Oats and Barley.
10. Advance Payments.
11. Crop Insurance.
12. Western Grain Transportation Act.
13. Prairie Branch Line Rehabilitation Program.
14. Research Expenditures.
15. General Support Programs of the Federal Government.
16. General Provincial Government Expenditures for Agriculture.
17. Farm Credit Programs.

It might be suggested by some that all the above programs and activities are not subsidies, but if they are not, why are they included in the draft treaty in the first place?

The attack on domestic farm programs of sovereign nations is clearly expressed in declarations of the U.S. Administration, as indicated in EXHIBIT B, attached.

Article 701(2) declares that "neither Party shall introduce or maintain any export subsidy on any agricultural goods originating in, or shipped from, its territory directly or indirectly to the territory of the other Party.

This is significant because when Canada , in 1986, imposed a 65¢ a bushel duty on imported U.S. corn, it did so on the basis that feed grains target payments were an export subsidy. That levy is still in force, now at a 46¢ a bushel rate.

Article 701(3) declares that "neither Party . . . shall sell agricultural goods for export to the territory of the other Party at a price below the acquisition price of the goods, plus any storage, handling or other costs." Yet, below cost is not well defined and could be the source of endless disputation.

Article 701(4) declares that each Party should avoid subsidized exports to third countries if such practices would have prejudicial effects on trade of the other Party. If strictly interpretted, this provision could hamper if not end, competition for markets.

Article 704 makes the U.S. Meat Import Acts of 1964 and 1979 inapplicable to trade between the U.S. and Canada.

Article 705(1) provides that the current Canadian import licenses could be lifted on U.S. wheat, barley, oats and products, if the U.S. subsidies on such products are equal to or less than the Canadian subsidies.

Article 707 allows Canadian products containing 10% or less of sugar, by dry weight, to be imported without duty. There is no limit on import of other sweeteners in combination with sugar.

Article 900 makes several concessions to Canadian energy interests, which would put U.S. industries (oil, natural gas, coal and uranium) at a disadvantage and act as a disincentive to U.S. exploration and drilling.

Article 1904 provides that judicial review of antidumping and countervailing dity determinations by appropriate courts (such as the U.S. Court of International Trade and other courts) would be replaced by arbitration by a supra-national panel of five political appointees of the U. S. President and the Canadian prime minister.

Article 401(1) provides that "neither Party shall increase any existing customs duty, or introduce any customs duty, on goods originating in the territory of the other Party." This has the effect of nullifying Section 22 of the Agricultural Act of 1935, which allows U.S. restrictions on imports when they interfere with the conduct of domestic farm stabilization programs. Section 22 is recognized under GATT since it predates the GATT pact. Any change in Section 22 or its termination should be considered by Congress on its own merits, not as part of a bill under a closed rule.

In conclusion, each one of the above Articles needs to be deleted before further consideration of the Treaty proceeds.

EXHIBIT A

D. PRIORITIES IN U.S. TRADE LEGISLATION

The U.S. Congress has before it two major pieces of trade legislation — H.R. 3, the Trade and International Economic Policy Reform Act, and H.R. 1154, the Textile and Apparel Trade Act. A third major trade measure, the U.S./Canada Free Trade Arrangement (FTA) is still to be submitted to Congress for action later in the session.

The debate about trade bills has been distorted by charges that a particular bill or particular provision is "protectionist." This is unfortunate when the criticism is leveled at a bill or section which merely insists upon fair trade or a level playing field. Such is the case with H.R. 3 and H.R. 1154. The latter, in fact, allows other trading nations to share in the growth of the U.S. market.

The Trade Reform Bill and the Textile Bill should be approved by Congress and signed by the President before any action is taken on the Free Trade Arrangement.

Over the years, National Farmers Union has studied the merits of a North American Common Market or a Common Market with the Pacific Rim nations. The proposed U.S./Canada pact is not satisfactory in its present form, and we, therefore, recommend that Congress send it back of renegotiation. Unless several objectionable provisions are deleted, we would have to recommend the eventual rejection of the treaty.

The most ill-advised and damaging provision of the treaty is the section which endorses the Reagan proposal in GATT to eliminate all farm programs in all nations within 10 years.

The language both in the U.S./Canada pact and in the Uruguay Round of Trade Talks attacks "agricultural subsidies which distort trade" but, in effect almost all government activities are interpretted as such subsidies. Subsidies include CCC payments, storage payments, the farmer-owned reserve, acreage reduction requirements, export enhancement and promotion, crop insurance, extension services, irrigation programs, inland waterways, conservation programs, commodity loans and credit services.

The treaty would nullify Section 22 of the Agricultural Act of 1935 which empowers the U.S. to act against imports which interfere with the conduct of U.S price support operations. The treaty would also make inapplicable between the two nations the U.S. Meat Import Acts of 1964 and 1979.

The treaty would put American grain growers and energy producers at a disadvantage.

Basically, the treaty makes a fundamental error in attempting to deal on a bilateral basis with trade problems which should be handled on a multilateral basis.

The underlying problem in world agricultural commerce is not access to markets but debased prices. It is not possible to address price problems in bilateral negotiations. Talks need to address price levels and, therefore, must be in a global arena with both exporting and importing nations fairly represented.

EXHIBIT B

REAGAN ADMINISTRATION STATEMENTS ON AGRICULTURAL OBJECTIVES IN THE URUGUAY ROUND OF TRADE TALKS

The U.S. proposal to end all domestic farm programs in all nations within ten years is clearly spelled out in the governmental declarations. Emphasis is added by underlining in some instances below:

The major U.S. objectives for agriculture once the multilateral trade negotiations are officially opened are:

1. to freeze the present level of export subsidies used in agricultural trade and to phase out the use of these subsidies over time,

2. to stop the growth of new barriers to agricultural trade and to phase out nontariff barriers that now exist,

3. to achieve greater harmonization of international food and plant and animal health regulations in order to facilitate greater international trade, and

4. to improve the dispute settlement process under GATT, so that once trading nations have agreed on better rules, there can be assurance that they will be applied consistently and dependably.

—Source: USDA /FAS Fact Sheet

AGRICULTURE IN THE URUGUAY ROUND

The United States has proposed the elimination of all policies that distort world agricultural production, prices and trade. Since domestic farm programs and trade policy are fundamentally bound together, free trade in agriculture requires reform of domestic agricultural policies as well as border measurees such as tariffs and quotas.

Many countries use a variety of policy measures that subsidize production or raise prices to consumers. These measures include tariffs, import quotas, variable import levies, export subsidies, price supports, direct government payments based on output levels, paid land diversions, production or input quotas, and subsidies for storage and inputs such as fertilizer, credit, insurance, fuel and transportation.

In most wealthy nations, where agriculture is a small part of the economy and generally has been heavily subsidized, farm programs have become increasingly distortionary, leading to higher farm prices relative to world prices, more restrictive import barriers, and increased government subsidies.

The most serious distortions and barriers related to international agricultural trade are caused by domestic programs in the industrialized countries that transfer income from consumers and taxpayers to owners of agricultural resources. Because these programs have been considered part of domestic policy, rather than international trade policy, it has been particularly difficult to include them in international negotiations.

In July 1987 the United States put forward a GATT proposal on agriculture . . . those programs that have a direct or indirect effect on international trade, including output subsidies, would be restricted.

—Source: ECONOMIC REPORT OF THE PRESIDENT, February, 1988

STATEMENT

OF

ALBERT E. POPE
PRESIDENT
UNITED EGG PRODUCERS
AND
UNITED EGG ASSOCIATION

Mr. Chairman, Members of the Subcommittee, I am Al Pope, President of the United Egg Producers and the United Egg Association. The United Egg Producers is a federation of regional cooperatives representing the majority of egg producers. UEA represents egg processors located throughout the United States. I appreciate this opportunity to share with the subcommittee the concerns of U.S. egg producers and processors regarding the Canadian Free Trade Agreement.

The egg industry supports the Administration's commitment to a free trade philosophy, but we respectfully point out that free trade, as an ideal or an actuality, cannot be achieved by forcing U.S. egg producers and processors to endure trade practices that have a detrimental impact on the domestic egg industry.

One such practice arises from the operation of the Canadian egg supply management program. The Canadian Egg Management Agency ("CEMA") controls flock size and production and purchases shell eggs from licensed shell egg producers at artificially high prices. Surplus shell eggs are subsequently sold at less than acquisition cost for processing as egg products. Such egg products are, in many cases, then exported to the United States where they depress domestic egg product prices despite the present tariff.

Under the Agreement, Canadian egg processors will have free access to United States markets with subsidized surplus egg products. Article 401:2(c) of the Free Trade Agreement eliminates tariffs from both the United States and Canada in ten equal annual stages over the next ten years. However, Article 706 allows Canada to maintain quantitative import restrictions on shell eggs. While the overall Canadian import quota is increased to 1.657 percent of the previous year's domestic shell egg production, this "increase" only reflects the annual average level of actual shipments over the past five years. Accordingly, access to the Canadian shell egg market remains restricted -- to accommodate the supply management system -- while the U.S. market will be completely open to subsidized surplus Canadian egg products.

This is particularly true for surplus egg yolks. With the recent expansion of worldwide demand for dried albumen, Canadian egg processors are disposing of increasing amounts of subsidized surplus egg yolks into the U.S. market. U.S. processors also compete for the world albumen market. For every pound of dried egg albumen produced, three pounds of dried egg yolk are left for disposal. U.S. markets are already burdened with domestic surplus supplies. In calendar year 1987, 3,823,295 pounds of egg yolk products were imported from Canada, while only 160,640 pounds of whites (frozen and dried) were imported during that same period.

Article 701:3 prohibits either government or a public entity which it has established or maintained, from selling agricultural goods for export to the territory of the other party at a price below the acquisition price of the goods plus any storage, handling or other costs incurred. It would appear that Article 703:3 was intended to prohibit the practice of exporting subsidized surplus Canadian egg products to the United States. However, we want to make certain that private egg processors who purchase eggs from CEMA will be prevented from selling the resulting egg products to the U.S. at less than the acquisition cost, plus storage, handling or other costs incurred.

This is particularly important to U.S. egg producers and processors because the bilateral commission dispute procedures provided by the Agreement appear to be no better -- and possibly worse -- than the current expensive, time consuming and often times ineffective remedies under the anti-dumping and countervailing duty laws or GATT procedures. Under these circumstances, the Agreement would continue to disadvantage U.S. egg processors with little or no adverse impact upon Canadian processors.

Another area of concern to U.S. egg processors is the potential abuse of the free access of Canadian products to the U.S. market by permitting Canadian processors to buy foreign surplus eggs, process and sell them at reduced prices into the U.S. market. Canadian processors should not be permitted to sell foreign product in the U.S. market that would not be permitted in their own market. We would like assurances that the rules of origin in the Agreement will protect the U.S. egg industry from such practices.

U.S. egg producers and processors as an industry, fully support free trade with Canada so long as they are treated fairly and allowed to compete equitably with our Canadian counterparts. The Agreement provides no additional incentive for Canadian egg producers to balance the supply and demand of eggs and egg products produced in Canada. As tariffs are reduced and eliminated over the course of the Agreement, we fear that more U.S. jobs will be exported as subsidized surplus Canadian egg products continue to be dumped on the U.S. market. Until the fundamental inequities to U.S. egg producers and processors contained in the current agreement are resolved or eggs are excluded from the Agreement, our members cannot provide their approval or support.

Before the
Senate Committee on Finance

Written Statement of the
Citizens for the U.S.-Canada Trade Pact

Mr. Chairman and Members of the Committee:

Good afternoon. My name is John Buckley. I am Vice President for Wholesale Marketing of Cumberland Farms, Inc. I appreciate this opportunity to present testimony on behalf of the Citizens for the U.S.-Canada Trade Pact, a coalition of which Cumberland Farms is a member.

I. INTRODUCTION

The Citizens for the U.S.-Canada Trade Pact urge Congress to implement promptly the Canada-U.S. Free Trade Agreement ("FTA"). The FTA constitutes a dramatic reaffirmation of the close political and economic relationship between the two countries.

As its core object, the FTA would eliminate tariffs on bilateral trade. The FTA also addresses a variety of more specific issues, including agricultural trade, trade in services. automotive trade, trade in financial services, energy trade and similar matters. Changes to the customs and international trade laws of both countries will be necessary to accommodate this new relationship. Finally, the FTA creates binational institutions to provide mechanisms for dispute resolution, to administer and interpret the FTA. and to conduct reviews of final determinations under both countries' antidumping and countervailing duty laws.

The FTA energy provisions will benefit both countries by allowing economic, not political, factors to play a greater role in determining energy trade and investment flows between the two countries. The energy provisions will promote an atmosphere of assurance that government intervention will not interfere with sound commercial relationships. They also will stimulate the attainment of natural economic efficiencies in energy trade. Moreover, the FTA will eliminate many of the uncertainties surrounding the investment climate in Canada.

Although its impact in the energy sector should not prove dramatic immediately. the FTA will eliminate the uncertainties about government intervention that impeded the development of otherwise logical economic relationships between the two countries. For these reasons, the Citizens for the U.S.-Canada Trade Pact support the prompt introduction and enactment of implementing legislation for the FTA under Congress' fast-track procedure.

II. INTEREST OF THE CITIZENS FOR THE U.S.-CANADA TRADE PACT

The Citizens for the U.S.-Canada Trade Pact ("CFTP") is an ad hoc coalition of petroleum products marketers who favor implementation of the FTA. Its members are Cumberland Farms, Western Petroleum Company, By-Lo Oil Co., Striker Industries, Mid-States Petroleum and Gull Industries. These companies market refined petroleum products, largely gasoline, along the northern tier of states from Maine to Washington state.

The CFTP emphasizes that its members' support of the FTA is reflective of their long-standing commitment to free trade generally. Members of the CFTP have long been proponents of unrestricted access to offshore supplies of crude oil and refined petroleum products. Even without an actual influx of imports of these products, the mere availability of alternative sources induces efficiencies and price discipline in the U.S. market. Those effects in turn benefit energy consumers. The CFTP's support for the FTA thus is part and parcel of its members' pro-competitive stance.

III. BACKGROUND ON U.S.-CANADA ENERGY TRADE

During the 1950s and 1960s, bilateral energy trade was not subject to the same degree of government intervention as in recent years. Increased imports into the United States, and ultimately the Arab Oil Embargo and its progeny, prompted both governments to intervene heavily in their respective oil markets. This interference not only impeded trade and investment flows, but also created an atmosphere of uncertainty that discouraged the development of long-term commercial and investment relationships. It should be noted that, although outside of the scope of this testimony, there also has been varying and substantial intervention by the two governments in non-oil energy markets.

A. U.S. Import and Export Controls

The United States has long maintained restraints on imports of crude oil and/or refined petroleum products. These restraints have affected imports from Canada to varying degrees.

In 1959, President Eisenhower established the Mandatory Oil Import Program ("MOIP") restraining U.S. imports of crude oil, unfinished oils, and refined petroleum products. But overland imports were exempted from the program. This exemption meant that Canadian oil transported by pipeline or other overland method could be entered into the United States and not be subject to import restraints.

The overland exemption was terminated in 1970, however, with respect to crude oil and unfinished oils. From 1970 to 1973. imports of crude oil and unfinished oils from Canada into regions east of the Rocky Mountains were subject to relatively liberal quotas.

The MOIP was replaced in 1973 by the oil import fee program. Although special treatment was once again afforded Canada. imports from Canada nevertheless were subject to a fee-quota arrangement. Imports of crude oil and unfinished oils could be entered without fee up to a liberal quota amount for Canada alone; imports in excess of the quota were subject to the fee. The quota could be raised if consistent with the purpose of the fee program. Moreover. imports of refined petroleum products from Canada were subject to fees along with refined products imports from all other sources. These restraints on imports were a component of price and allocation controls in the domestic market. The fee program was terminated with respect to all imports in 1980.

U.S. exports of crude oil and refined petroleum products have remained modest since 1959. Indeed, exports of crude oil have been effectively embargoed since the imposition of price and allocation controls in 1973. An exception was allowed for what were essentially barter exchanges with Canada. Since 1985, exports of crude oil from the lower 48 states have been allowed. but only to Canada. Refined products exports have been permitted and have increased significantly since liberalization of the U.S. export licensing program in 1981.

The ability to import and export crude oil and refined petroleum products thus has been subject to frequent and changing U.S. government regulation. Although the United States' special relationship with Canada was recognized consistently in these programs. imports from Canada nevertheless were regulated starting in 1970. The changing and frequent U.S. government intervention injected great uncertainty into the bilateral oil market.

B. Canadian Government Intervention

Before the Arab Oil Embargo in 1973. Canada allowed liberal U.S. access to its oil resources. That event marked a watershed in Canadian oil policies, however. Subsequent Canadian oil policies displayed a much more protective attitude toward its oil resources.

As noted. U.S. import restrictions did not apply to overland imports until 1970, and Canada refrained from restraining its exports until 1973. U.S. imports of crude oil and refined petroleum products from Canada thus grew steadily and dramatically throughout the 1960s. Despite the imposition of U.S. import quotas in 1970, U.S. imports of all crude petroleum and refined petroleum products from Canada continued to grow until 1973. when it reached a peak of nearly 484 million barrels (or an average 1.3 million barrels per calendar day).

In that year, however, Canada reacted dramatically to the world panic engendered by the Arab Oil Embargo. Canada imposed crude oil and refined products export restraints in March 1973. Sharp increases in shipments to the United States preceded this action. Canada further implemented an export tax in September 1973 to make domestic price controls effective. U.S. imports from Canada fell sharply to 170 million barrels in 1978, and fluctuated until they reached a post-1968 low of 163 million barrels (447.000 barrels per calendar day) in 1981.

Between 1973 and 1985, therefore, Canada has had a regulated oil market. The Canadian government controlled prices in Canada. and export restraints continued in the form of a surplus test and export licensing requirements. With the recent oil glut, there has been liberalization and decontrol since 1985. Indeed. U.S. imports of all petroleum products from Canada have increased steadily since 1981 to reach 288 million barrels in 1986 (or an average 789,000 barrels per calendar day).

The Canadian government also interfered significantly in energy investment. During the 1960s. foreign ownership expanded dramatically. Some limited restrictions were adopted (such as the limits on production licenses on federal lands), but serious action was not taken until the 1970s. and then in conjunction with a broader program to limit U.S. involvement. During that decade, the government of Prime Minister Pierre Elliot Trudeau introduced the Foreign Investment Review Act program. This program enabled the Canadian government to screen and, where it deemed appropriate. prohibit the acquisition of Canadian business enterprises. The general program was prompted by a Canadian perception that U.S. investors were increasingly dominating Canadian industry.

These broader concerns were accentuated in the case of oil because of its importance and because of fears that without government intervention Canada would be relegated to the role of a supplier of natural resources to the United States. Petro-

Canada -- a federally-owned corporation -- was created in 1975. and rapidly became Canada's sixth largest producer. The most draconian intervention, however, was effected through the National Energy Program ("NEP") implemented in 1980. The NEP contained a requirement of 50 percent Canadian ownership of the oil and gas industry by 1990. and other Canadianization provisions. U.S. investors immediately began to sell their ownership shares so as to secure the maximum possible value before the forced divestment. This policy has been eased substantially since 1984, however.

C. Consequences of Policies of Government Intervention

There thus has been a history of substantial government intervention in the energy markets of the United States and Canada since 1970. This interference has had two consequences.

First, government intervention has interfered in the operation of the market. Long-term contracts for supply have been discouraged. Indeed. current Canadian regulations require the insertion of a clause in oil export contracts relieving the Canadian exporters of their obligation to export if restricted by the Canadian government. Moreover, U.S. ownership of Canadian energy companies was subject to forced divestment under the NEP. reducing the return received by U.S. investors.

Second, and more importantly, this tradition of government intervention injected considerable uncertainty into the market. Perhaps more significant than the mere presence of government intervention was the frequent change in the intensity and form of government intervention. In a stable. albeit pervasive. regulatory environment. businesses can still enter into long-term relationships because they have confidence in the perpetuation of the current rules of the game. Even though the relationship might be structured differently than without government interference, the relationship nonetheless would develop.

An atmosphere of frequent changes in the rules of the game. however. causes perceptions of greater risk. U.S. importers have been discouraged from relying on Canadian supplies -- despite the fact that they might be the most logical in terms of cost. geography. and similar factors -- because of the very real possibility that future U.S. import restraints or Canadian export restraints would make continued access difficult or impossible. Conversely, a Canadian exporter cannot feel assured about exporting to the U.S. market when Canadian government export restraints or U.S. government import restraints could subsequently deny market access. Nor can a U.S.

investor feel secure about an investment which may become subject to new and more rigorous Canadian equity limits, and even divestment requirements.

Government interference in the market, and the consequent uncertainties it created, have prevented the achievement of economic efficiencies possible from close and logical bilateral relationships. The FTA promises to permit, to the extent appropriate, the creation of long-term commercial and investment relationships. These relationships will be dictated by economic factors, not by political circumstances, and thus will benefit consumers in both markets by virtue of enhanced efficiencies and other effects. In many senses, therefore, the FTA constitutes a return to conditions in the bilateral market preceding the tumultuous events in the world energy market of the 1970s.

IV. THE IMPACT OF THE FTA IS TO REMOVE THESE ARTIFICIAL IMPEDIMENTS TO BILATERAL RELATIONSHIPS AND THE ACHIEVEMENT OF ECONOMIC EFFICIENCIES

The FTA will have two basic effects on bilateral trade in the energy sector. First, the FTA will stimulate greater assurance about the government regulatory environment, which will inspire confidence in the creation of commercial and investment relationships as well as help to dampen panic in the event of dramatic disruptions in the world energy market. The FTA also will stimulate the achievement of economic efficiencies that otherwise might be lost because of government intervention in the market. These consequences in turn have favorable implications for both U.S. and Canadian energy security.

A. The FTA Will Stimulate Certainty as a Basis for Bilateral Relationships in the Energy Sector

The FTA will stimulate greater certainty in the business community regarding doing business in Canada or in the United States. The FTA will reduce risks posed by entry into bilateral commercial or investment relationships.

Before turning to the ramifications of this greater certainty, however, "certainty" must first be defined. It means a greater level of confidence that political or nationalist factors will not alter or destroy bilateral relationships. In essence, greater certainty causes the reduction of risk assessments relating to doing business in Canada or the United States. The greater certainty about the future fostered by the FTA also relates to the degree of panic that results from dramatic dislocations in the world energy market; the sense of security engendered by a stable bilateral energy relationship should help to moderate panic in the event of a sharp disruption of supplies from, for example, the Middle East.

1. Commercial Relationships

The FTA will stimulate this greater certainty in three ways. First, it will facilitate the establishment of long-term commercial relationships where dictated by geography and other economic factors. The FTA reaffirms the obligations with respect to energy of both governments under the General Agreement on Tariffs and Trade ("GATT"). This incorporation of GATT into the FTA means that quantitative import restraints may only be imposed in certain, limited circumstances. Moreover, the FTA specifically acknowledges that GATT prohibits minimum-export and minimum-import requirements in all circumstances in which other quantitative restraints are prohibited. These provisions will assure that import restraints are confined to types (and implemented in accordance with procedures) agreed upon by both governments in GATT.

With respect to export measures, the FTA will ensure that supplies are not totally disrupted. An export restraint may not limit Canadian exports to the United States (or vice versa) below the U.S. share of total Canadian supply during a recent representative period. In addition, export restraints may not include government measures that result in a higher price for exports than for domestic sales of the energy product. Finally, the FTA prohibits the incorporation in export restraints of government measures that would disturb normal channels of supply or normal product mixes (for example, the proportion between crude oil and refined products in total exports).

The FTA thus promotes greater certainty in access to supplies. That additional assurance is particularly important when assessing the risks entailed by another oil crisis. The FTA alleviates, with respect to Canada at least, some of the fear that another world oil crisis would bring a repetition of the Canadian export or U.S. import restrictions.

2. Investment Relationships

Second, the FTA will foster the establishment of long-term investment relationships. The FTA will permit investment relationships to be determined more by capital availability, reserves and market conditions than by political factors. Moreover, U.S. investors will not have to hold as great a fear of nationalization, minimum equity restrictions, performance requirements, or the like imposed by a new Canadian government.

The FTA accomplishes this by "locking in" the more liberalized current Canadian investment rules applicable to the energy sector. Under the FTA, Canada may impose energy investment regulations no more restrictive than those in force on October 4, 1987. These regulations have been dubbed the Masse Policy, which embodies a set of rules regarding various aspects of energy investment.

The Masse Policy contains the following major elements:

- Foreign investors will be prevented from directly acquiring a healthy Canadian company in the oil and gas sector.
- Nevertheless, the Canadian government will consider permitting the direct acquisition of a Canadian business that is financially unsound by U.S. investors. If a Canadian oil and gas enterprise is already foreign-owned, the Canadian government will normally permit sale to another foreign investor, albeit perhaps with some generalized commitment to expand Canadian ownership.
- With respect to indirect acquisitions, the Canadian government may insist upon some general commitment to expand Canadian ownership without imposing any specific requirements.
- The Canadian government will continue to require that entities seeking production licenses for Canadian federal lands be 50 percent Canadian owned.

In essence, Canada committed in the FTA to maintaining an investment policy in the energy sector that is no more restrictive than the Masse Policy.

The Masse Policy obviously perpetuates some obstacles to U.S. investment in the Canadian energy sector. By mandating that the Masse Policy is the maximum degree of government intervention, however, the FTA provides substantially greater certainty for potential U.S. investors. Canadian energy investment policies have fluctuated, but displayed a general movement toward greater "Canadianization" in ownership regulations since the 1960s. This trend culminated with the NEP's requirement of 50 percent Canadian ownership by 1990, and the associated buyout of U.S. energy investments by Canadian investors. This program abated somewhat with the advent of the Masse Policy. The FTA minimizes the risk of a repetition of this evolution and thus provides greater clarity for U.S. investors. This greater assurance -- that the investment climate in Canada will remain stable for the foreseeable future -- is a positive development despite the retention of substantial Canadian government regulation of investment in the energy sector.

3. Effects in the Event of Market Disruption

Finally, the assurances provided by the FTA will help to assuage, albeit not eliminate, the panic that normally follows dislocations in the international energy market. It is this panic, rather than actual physical supply shortages, that has tended to cause rapid oil price increases.

In the future, the United States will inevitably be reliant to some degree on foreign oil supplies. This reliance need not amount to vulnerability, however. If events in a politically unstable region like the Middle East disrupt oil supplies, the assurance of access to Canadian supplies embodied in the FTA will help to dampen the panic. As noted above, there will be less chance of a repetition of the Canadian government export restraints that followed the Arab Oil Embargo in 1973. The FTA provisions, moreover, signify to the market that not all foreign sources of crude oil and petroleum products are susceptible to political interference, and that the impact of a disruption in supply should be evaluated in its specific regional context rather than immediately assumed global in scope.

B. The FTA Will Stimulate the Achievement of Economic Efficiencies in Bilateral Energy Trade

The FTA also will stimulate the attainment of economic efficiencies in bilateral energy trade. The history of government intervention related above has hindered or prevented the achievement of such efficiencies. Although they will not be dramatic in magnitude, there are clear economic complementarities that can be developed, if only by virtue of the elimination of tariffs or geography. Moreover, long-term investment relationships are made more possible by the FTA, thereby enhancing the likelihood of the long-term development of high cost Canadian reserves.

1. Elimination of Tariffs

The clearest complementarity of the FTA will be the benefit provided consumers through the elimination of tariffs. U.S. tariffs on crude oil and petroleum products are significant; their elimination will yield substantial benefits for U.S. consumers, especially along the northern tier.

Current U.S. tariffs on crude oil equal either 5.25 cents per barrel or 10.5 cents per barrel, depending upon the oil's specific gravity. For petroleum products, U.S. tariffs range from 5.25 cents per barrel on distillate and residual fuel oils (with a specific gravity under 25 degrees API) to 52.5 cents per barrel on motor fuel and 84 cents per barrel on lubricating oils. Imports of kerosene and naphthas, except those qualifying as motor fuel, are assessed a duty of 10.5 cents per barrel.

U.S. imports of these products from Canada are substantial and growing. U.S. imports of crude oil and shale oil from Canada, for example, increased from 175 million barrels in 1985 to 209 million barrels in 1986. Moreover, Canada is one of the most significant sources of U.S. crude oil imports, accounting for more than 12 percent of total crude oil imports in each year since 1985. Canada placed within the top three sources of U.S. crude oil imports during that period. A similar situation exists with respect to petroleum products. Canada has been a leading source of U.S. imports of motor fuels and lubricating oils, among other items.

The elimination of tariffs on these imports will provide substantial savings to U.S. consumers. This benefit of the FTA can be illustrated by using 1986 as an example. In that year, U.S. consumers paid $17.8 million in regular customs duties on imports of crude oil from Canada, and another $6.9 million in duties on imports of Canadian gasoline. These costs were concentrated disproportionately among consumers along the northern tier of states. During the period January-October 1987, for instance, only 2.3 percent of Canadian crude oil and 11.0 percent of Canadian gasoline was imported through ports outside of the northern tier. Nor are these imports distributed widely once entered; generally, they are refined and/or marketed regionally where imported.

The elimination of tariffs on imports of Canadian crude oil and petroleum products thus will mean substantial savings for consumers of these products, especially in the northern United States. This is the clearest and most direct, but by no means the sole, benefit of the FTA energy provisions.

2. Commercial Relationships

Simple geography dictates that there are many complementarities along the northern tier of the United States. Regional situations in both countries -- such as location of transportation facilities, location of refineries and terminals, location of pipelines, local competitive circumstances and the like -- inevitably will lead to complementary relationships along the borders. Some clear potential examples include:

- Canadian Crude Oil and Northern Tier Refineries

  There are existing relationships between U.S. refineries in the Midwest and Canadian crude oil exporters. A major pipeline runs from Edmonton, Alberta through Minnesota, Wisconsin, Illinois, Indiana and Michigan before returning to Canada near Windsor, Ontario. Refineries located near St. Paul and Chicago have long obtained crude oil supplies through this pipeline. In the period January-October 1987, for example, more than 69 percent of total U.S. crude oil imports from Canada entered through Minnesota or Illinois customs districts. The FTA will provide greater assurance that those supplies will remain secure. Moreover, the U.S. Midwest contains asphalt refineries and refineries capable processing heavier grades of crude oil. These refineries can complement Canadian producers of heavy oil and tar sands as those higher cost resources are exploited in the future.

- Alaskan North Slope Crude Oil and Western Canadian Refineries

An opposite complementarity might exist along the U.S. West Coast. Crude oil extracted from Alaskan North Slope ("ANS") fields has engendered an oil surplus west of the Rocky Mountains in the United States. There are no U.S. pipelines available to transport this oil to the more needy Eastern regions. U.S. law, moreover, generally prevents the exportation of this oil, even to refineries located just across the border in Vancouver, British Columbia. The FTA would allow the export of a limited quantity (50,000 barrels per day on average) of ANS crude oil to these refineries. Moreover, the requirements of the Jones Act will still be respected by the FTA. Under the FTA, the ANS crude oil must be shipped by tanker to Washington state before being transported by pipeline to Vancouver. In turn, gradually diminishing supplies of Canadian light crude oil can be redirected East to Canadian and U.S. refineries serving the Midwest and Atlantic regions. Both countries thus can benefit by a more efficient and secure regional allocation of crude oil supplies.

- Canadian Energy Supplies Serving New England

The scarcity of various energy resources in New England is well known. The FTA will provide a more favorable atmosphere for the establishment of long-term complementary relationships in the energy sector to ameliorate these problems. Canadian refineries located in Newfoundland and Nova Scotia can serve New England refined products markets. In the period January-October 1987, for example, 4.1 million barrels of Canadian gasoline entered the United States through New England customs districts. These imports represented more than 46 percent of total U.S. gasoline imports from Canada. Under the FTA, the Canadian refineries can be more assured that those markets will remain open while U.S. consumers can be more assured that those supplies will remain available. The same effects would hold true in the realm of hydroelectric energy, where Quebec has expressed an interest in exporting more electricity into New York and New England.

- Transportation of Beaufort Sea Crude Oil through the Trans-Alaska Pipeline

A more speculative, long-term complementarity might be cooperation in the development and transportation of remote Arctic reserves. For example, the Trans-Alaska Pipeline could be used to transport crude oil production from remote northern Canada. Canada appears to have substantial reserves in the Beaufort Sea-Mackenzie River Delta region along its northern coast. These reserves, however, are located in a harsh environment and are very costly to develop and produce. In the event that the world price of oil rises to a substantially higher level, these reserves may become more justified economically. A logical complementarity therefore would be to avoid the enormous expense and ecological risk of constructing a new pipeline when the crude oil could be transported through the existing Trans-Alaska Pipeline. Other, similar complementarities in these remote northern regions also can be envisioned.

3. Investment Relationships

The FTA also could stimulate the achievement of efficiencies in the area of investment and even the sharing of technology. These benefits appear more speculative because of current conditions in the world energy market. Nevertheless, the FTA will provide a stable foundation for the mutually beneficial development of petroleum reserves when justified by conditions in the world market.

Both the United States and Canada possess substantial oil reserves that are extremely expensive to exploit. Colorado and Wyoming in the United States, and Alberta and Saskatchewan in Canada, contain large reserves of tar sands and/or heavy oil. Moreover, Canada has potentially large reserves in the Beaufort Sea/Mackenzie River Delta region and offshore along its Atlantic coast. All of these reserves are extremely costly to explore, develop and produce. The tar sands/heavy oil require special processing to convert into synthetic fuels to be used commercially. Although apparently comprised of lighter grades of crude oil, the Arctic and offshore reserves are in remote, harsh environments. Indeed, certain reserves may not yet be recoverable because of the need for more advanced technology before commercial operations could commence.

The development of these reserves cannot be justified economically under present market conditions. The world oil price is simply not high enough to stimulate investment, exploration or development. The artificial stimulation of such development would not benefit either country because it would require protected markets in which the price of oil would be considerably higher than the international price. Such a differential would undermine the competitiveness of energy-consuming industries in both countries.

If and when the world oil price does reach appropriate levels, however, the FTA will further stimulate the exploitation of these high cost reserves in two ways. First, it will provide a larger assured market over which to spread development and production costs. The oil produced from these reserves will flow to its natural markets, rather than to markets circumscribed by political factors.

In addition, the FTA will provide a stable investment climate. Such stability will be important given the large amount of capital needed. Under the FTA, a larger pool of capital will be available from which to draw for the exploitation of these high cost resources.

Finally, technology flows may be enhanced by the FTA. The more remote reserves, as noted, will require advanced technology to be made commercially feasible. Synthetic fuel production, deepwater operations, and harsh Arctic environment operations all will benefit by a sharing of experience and technology between the national oil industries. The greater atmosphere of assurance fostered by the FTA will facilitate the sharing of this technology. The FTA will dampen fears, for example, that technology shared will later be nationalized and used against the provider. The long-term relationships permitted by the FTA, and the greater confidence it inspires, will provide a solid basis for the necessary cooperation.

Various economic efficiencies thus will be promoted by the FTA. The least cost alternative for crude oil and refined products will prevail along border regions, stimulating competition and benefitting consumers. The FTA also will engender price discipline simply by virtue of the availability of assured alternate sources of supply. The mere availability of crude oil and refined products from Canada, in other words, will provide an incentive for U.S. producers to engage in competitive pricing. Finally, the FTA may accelerate the rate at which high cost reserves are brought into production, when otherwise justified by world market conditions, because the FTA will provide a larger assured market for production and a more favorable investment climate.

C. Implications for Energy Security

The FTA will have beneficial implications for energy security for both countries. Although the FTA will not provide immunity from world market conditions, it will render both countries better able to withstand the political exploitation of energy resources or sharp disruptions of supply.

The FTA will provide the foundation for the complementary, efficient and sound operation of the U.S. and Canadian energy markets. Such markets should prove more resilient and more secure in a volatile world energy market. The assurance of Canadian supplies, for example, should dampen the panic that often follows interruptions in the flow of Middle Eastern supplies.

Finally, both countries will benefit by the greater political and economic flexibility permitted by resilient energy markets. The actual and perceived vulnerability of the United States to Middle Eastern sources of supply, for example, will be reduced by the assurance of supplies from Canada. The United States accordingly will be better able to select policy options that will lead to long-term stability in the region as opposed to policy options that might expediently assure continued flow of petroleum supplies in the short run.

V. CONCLUSION

The FTA should not be expected to cause dramatic changes in the U.S. and Canadian oil markets. Rather, it should be viewed as an exercise in foundation-building. The FTA will place bilateral oil trade on a sound footing by permitting economic, rather than political, factors to play a greater role in determining bilateral trade in crude oil and refined petroleum products as well as bilateral investment flows. In many ways, the FTA constitutes a restoration of the more rational bilateral energy policies of the 1950s and 1960s. The Citizen for the U.S.-Canada Trade Pact therefore believe that the FTA is in the best interests of the United States as well as Canada, and urge its prompt implementation.

Thank you for your kind attention. I will be pleased to answer any of the Committee's questions at this time.

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